Report 2: August 2010

OBSERVATIONS ON FINANCIAL REPORTING: SUMMARY FINANCIAL STATEMENTS 2009/10

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Auditor General
of British Columbia

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The Honourable Bill Barisoff
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
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Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2010/11 Report 2:Observations on Financial Reporting: *Summary Financial Statements 2009/10*

John Doyle, MBA, CA
Auditor General

Victoria, British Columbia
August 2010

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AUDITOR GENERAL'S COMMENTS

JOHN DOYLE, MBA, CA
Auditor General

THE AUDIT of the Summary Financial Statements is a significant body of work for my Office. This is the largest financial statement audit carried out in British Columbia, involving about 150 separate government organizations and consuming thousands of hours of my staff's time, and that of many private sector auditors.

My audit opinion for the 2009/10 fiscal year contains three audit reservations – areas where the financial statements are not in compliance with Canadian Generally Accepted Accounting Principles (GAAP). These are the same three audit reservations that featured in the 2008/09 opinion.

Canadian auditing and accounting standards are undergoing significant change. Audit practitioners, including my Office, will be implementing international audit standards during the 2010/11 fiscal year. Also, publicly accountable organizations will soon be adopting International Financial Reporting Standards (IFRS) and organizations within the government reporting entity may change their basis of GAAP.

In response to the potential impact of these changing accounting standards, government amended the Budget Transparency and Accountability Act (BTAA). The amendments allow government to depart from Canadian GAAP for the Summary Financial Statements. Of particular concern to government is whether or not rate-regulated accounting will continue to be permitted in the future. Recent events suggest that standard setters will allow rate-regulated accounting to continue for two years longer than originally planned, until January 1, 2013, and government has therefore indicated it will not utilise the BTAA amendments.

This report also includes:

- results of a survey we undertook on governance practices across the government reporting entity;
- a summary of internal control issues described in auditors' letters to the management of government organizations and their governing boards;
- recommendations to government that will improve its accounting and reporting of transactions; and
- explanations of issues that were encountered during the audit that will be of interest to legislators and the public.

In closing, I wish to thank all staff in my Office and in the private sector audit firms who assisted in the audit of the 2009/10 Summary Financial Statements.

John Doyle
August 2010

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INTRODUCTION

ON JULY 8, 2010 THE PROVINCIAL government released the audited Summary Financial Statements of the Province of British Columbia for the year ended March 31, 2010.

The Summary Financial Statements report the consolidated financial results of the entities that make up the government reporting entity – this includes eight legislative offices, the legislative assembly, the Office of the Premier, 20 ministries and 147 other organizations including Crown corporations, school districts, universities, colleges and health organizations. The Summary Financial Statements are an important document for the people of British Columbia as it provides an indication of the financial well-being of the Province.

The audited Summary Financial Statements are included in government's Public Accounts (available online at www.fin.gov.bc.ca/OCG/pa/09_10/Pa09_10.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 and the Provincial Debt.

KEY ISSUES

There are important issues behind the financial statement figures that should be brought to the public's attention. The five most significant accounting and audit issues are these:

1. The Auditor General has given a qualified audit opinion on the Summary Financial Statements because the statements do not comply with generally accepted accounting principles (GAAP). All three of this year's reservations were also included as reservations last year. First, oil and natural gas producer's royalty credits are inappropriately being netted from revenue rather than being reported as expenses. Second, government is not recording liabilities for deep-well credits owed to oil and gas producers. The third reservation is the improper consolidation into the Summary Financial Statements of the Transportation Investment Corporation (TIC). Consolidating the accounts of the TIC using the modified equity method rather than the line-by-line method results in significant differences in the financial statement balances. For more details, see *2009/10 audit opinion reservations* on page 5 of this report.

2. Accounting standards will be changing in the near future. This could have a significant impact on how government accounts for transactions. See *Accounting standards are changing* on page 7 of this report.

3. Accounting by rate-regulated entities such as the BC Hydro and Power Authority is a significant issue. If government had not been permitted by current accounting standards to defer certain expenses, the annual deficit would have been about $700 million higher this year. See *Rate-regulated accounting* on page9.

4. The government's response to changing accounting standards included an amendment to the Budget Transparency and Accountability Act that provided government with the flexibility to change how it defines generally accepted accounting principles. See *Government's response to changing accounting standards* on page 10.

5. Government has improved its management of working capital by reducing its cash and temporary investment balances from about $7 billion as at March 31, 2009 to $3 billion as at March 31, 2010, but it can still do better. See *Working capital management* on page 11.

Also of key interest is a compilation of the recommendations of all the auditors' "management letters" across the government reporting entity. Management letters are a way for auditors to communicate significant issues found during an audit to management and governing boards. The number and significance of issues brought forward show there is room for improvement in the operations of government. See *Management Letters: A Wealth of Information* on page 12.

And finally, we are including a summary of a survey we undertook this year that looks at governance across the government reporting entity. Overall, the survey results were positive, with the majority of entities reporting that they used a range of governance good practices. We summarize the results and key observations of the survey in this report. See *Governance Survey: Summary of Results* on page 19.

OTHER ISSUES WITH RECOMMENDATIONS TO GOVERNMENT

For a number of issues, we provide recommendations to government that will improve the quality of future Summary Financial Statements and of government's accountability to legislators and the public. A number of the recommendations are ones we have discussed in the past but which government has not yet implemented. We continue to discuss them because they are important issues and should be resolved.

The recommendations related to these issues are in addition to those implicit in the audit opinion reservations. Topics that include recommendations include:

- *Complete disclosure of prior year adjustments* – Prior year adjustments require additional disclosure. See page 23.
- *Ministry financial statements* – Ministries should prepare financial statements for their areas of responsibility. See page 23.
- *Accounting for First Nations settlement costs* – Government needs to review its accounting for First Nations transactions to ensure they are in accordance with GAAP. Although not material this year, future transactions could result in audit reservations in the Auditor General's opinion on the Summary Financial Statements. See page 24.
- *Accounting for inherited Crown land* – When valued, land should be recorded as an increase to accumulated surplus or deficit, not revenue. See page 24.
- *Classification of debt* – Warehouse debt and debt of the Transportation Investment Corporation should be disclosed as taxpayer-supported debt, not self-supported debt. See page 25.
- *Disclosure of contractual obligations* – Contractual obligations should include additional disclosures, and a lower threshold should be used when accumulating the information. See page 26.
- *Pension plan disclosures* – Government should improve its disclosure of pension plans as required by generally accepted accounting principles. See page 27.

OTHER ISSUES OF INTEREST

In this report we also discuss other issues of interest, without specific recommendations to government. These topics include:

- *The government reporting entity – what's in and what's out?* See page 28.
- *Inclusion of universities in the government reporting entity.* See page 29.
- *Outsourcing of government operations and their impact on the audit.* See page 30.
- *Accounting for debt using equity accounting.* See page 30.
- *Accounting for impaired investments (Children's Education Fund).* See page 31.
- *Accounting for payments for the 2010 Olympic security costs.* See page 32.
- *Carbon neutrality.* See page 32.
- *Accounting for the HST transitional assistance funding.* See page 33.
- *Accounting for bonus bid revenue.* See page 33.
- *Long amortization of tangible capital assets.* See page 33.
- *Accounting standards that are in the consultation stage.* See page 34.

ACCOUNTING FOR AND AUDITING THE SUMMARY FINANCIAL STATEMENTS

Finally, in this report we provide some background information on topics such as the composition of the government reporting entity, and how we go about auditing the financial statements of an organization as large as the Province of British Columbia. These topics include:

- *Composition of the government reporting entity.* See page 35.
- *Government's financial reporting framework.* See page 35.
- *The accounting consolidation process.* See page 35.
- *Auditing the Summary Financial Statements.* See page 36.
- *Materiality and the auditor's role in informing users of departures from Canadian GAAP.* See page 38.
- *New Canadian auditing standards.* See page 39.

1. 2009/10 AUDIT OPINION RESERVATIONS

During our audit of the Summary Financial Statements for the year ending March 31, 2010, we discussed a number of significant issues with government, many of which were resolved satisfactorily. Government made more than 25 monetary adjustments to the Summary Financial Statements at our request, as well as a number of other adjustments to disclosures in the financial statement notes and schedules.

However, government chose not to adjust a number of other items in the financial statements and notes. As a result, the Auditor General expressed three reservations in his audit opinion for departures from Canadian generally accepted accounting principles (GAAP). The effect of these reservations on the statement of financial position and the results of operations is shown in Exhibit 1.

Had the adjustments been made, the deficit for 2009/10 would have been $1,852 million, not the $1,779 million reported by government – a difference of $73 million.

Exhibit 1 : Impact of the Auditor General's audit reservations on the Summary Financial Statements for the year ended March 31, 2010 ($ million)

	As reported	Audit adjustment required	As corrected
Financial assets	*$31,675*	*($663)*	*$31,012*
Liabilities	*59,712*	*468*	*60,180*
(Net liabilities)	*(28,037)*	*(1,131)*	*(29,168)*
Non-financial assets	*33,309*	*948*	*34,257*
Accumulated surplus	*$5,272*	*($183)*	*$5,089*
Revenue	*$37,521*	*$444*	*$37,965*
Expense	*39,300*	*517*	*39,817*
Surplus (deficit) for the year	*($1,779)*	*($73)*	*($1,852)*

Full consolidation of the Transportation Investment Corporation

The government has consolidated the Transportation Investment Corporation (TIC) using the modified equity method – a method that would be appropriate if the TIC was a government business enterprise. In our opinion, however, the TIC does not yet qualify as a government business enterprise and so should be fully consolidated.

Had it been fully consolidated, all of its assets, liabilities, revenues and expenses would have been included in the Summary Financial Statements. Instead, being consolidated using the modified equity method means that only the government's investment in the TIC, amounts owed to and by the corporation and the net loss have been included in the Summary Financial Statements. The result for fiscal 2009/10 has been:

- understating cash by $15 million;
- overstating equity in self-supported Crown corporations by $138 million;
- overstating loans for purchase of assets, recoverable from agencies by $540 million;
- understating tangible capital assets by $948 million;
- understating accounts payable and accrued liabilities by $291 million;
- understating taxpayer-supported debt by $544 million; and
- overstating self-supported debt by $544 million.

Also, had the TIC been fully consolidated, there would be changes in the notes to the financial statements – that is, contractual obligations totalling $1,993 million would be classified as being for taxpayer-supported Crown corporations instead of for self-supported Crown corporations.

The purpose of the TIC is to develop and operate toll highways. The first one is the Port Mann Highway Improvement project, which includes the Port Mann Bridge and improvements to Highway 1.

In assisting us in forming our opinion the government gave us information about the future construction plans and projections of revenue and expense for the TIC. The projections are based on policy decisions that will be implemented as well as on estimates of future costs and traffic volumes. We have not audited the information.

Although we have not audited the TIC's projections, we have analysed its financial model, including the assumptions related to capital costs, toll revenues, debt and related interest expense. We identified a number of areas in the model where further clarification is needed. Examples are the sensitivity of the financial model to key variables such as annual toll increases and traffic volumes, the interrelationships of various components of debt (short-term debt, long-term debt and sinking funds), and the corporation's plans for the continuance of tolling and any surpluses in future years. Management of the TIC has stated that it will be re-examining its model for toll revenue projections during this fiscal year, 2010/11.

For a corporation to qualify as a government business enterprise, Canadian GAAP requires the organization to:

a. be a separate legal entity with the power to contract in its own name and that can sue and be sued;
b. have been delegated the financial and operational authority to carry on a business;
c. as its principal activity, sell goods and services to individuals and organizations outside of the government reporting entity; and
d. in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

In our view, the TIC currently has the characteristics of (a) and (b), but not of (c) and (d).

The service that government will sell to the public is the use of the Port Mann Bridge. However, given that the bridge is not expected to be ready for use until 2013/14, the government will not begin collecting tolls and will not be in compliance with requirement (c) for several more years.

The requirement in (d) that TIC maintains its operations and meets its liabilities using revenue from sources outside of government means, in effect, that the corporation must be profitable. These profits can then be used by the TIC to retire its debt. The TIC cannot rely on making sales to, or receiving subsidies in cash or kind from, other parts of government. According to government's projections, the TIC will not maintain a profitable status for almost a decade – beginning in 2018/19. Therefore requirement (d) has not yet been met.

Only when the TIC meets all of the requirements (a) through (d) can it be consolidated into the Summary Financial Statements using the modified equity method.

For all of these reasons, we have included a reservation in our audit opinion on the Summary Financial Statements for 2009/10. The TIC does not yet meet the definition of a government business enterprise.

As the TIC may qualify as a government business enterprise in the future, we will review the situation annually.

Provision for deep-well credits and the recording of oil and natural gas producers' royalty credits

Starting with fiscal 2008, we asked the government to record a provision for deep-well credits that have been earned but not claimed, and to record the incentives granted to oil and natural gas producers as expenses instead of deducting the incentives from revenues, as required by Canadian GAAP. The government has decided to do neither of these, and so we have included two reservations in our audit opinion.

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 then the government calculates the credit earned as a result and issues a certificate to the producers. Government also keeps its own record of the amount of the credit for each well. When production starts, government calculates a monthly amount of royalty 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. Although the credits can only be used for royalties from the specific well, they are transferrable to different owners if ownership of the well changes.

Canadian GAAP 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 may be some uncertainty about when government will have to act on the liability, its existence is clear.

The total amount of earned and unclaimed credits at March 31, 2010 was $177 million.

This deep-well credits program is one of a number of incentives that government provides to oil and natural gas producers. Other programs provide credits for road construction and summer drilling, and to induce activity in marginal, ultra-marginal and low-production wells.

These incentives are being deducted from oil and gas royalty revenues in the Summary Financial Statements.

According to Canadian GAAP, 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 Canadian GAAP allows credits to be deducted from taxes, these royalties are in the nature of an exchange transaction rather than a non-exchange transaction (taxes), given that the producers are paying for the extraction of the oil and gas public assets. In our view, therefore, the credits deducted from the royalties should be added back and shown as expenses instead of being deducted from revenues.

The amount of the credits deducted from revenues in 2010 (rather than being shown as expenses) was $444 million – the amount by which revenues for 2009/2010 have been understated.

This $444 million includes $104 million of deep-well credits that should have been expensed in 2008/09, but does not include the $105 million of deep-well credits that should have been expensed in 2009/10 or the $32 million in credits used in 2009/10. So, the amount by which expenses are understated in 2009/10 is $517 million.

Taken together, the net effect of these two reservations is that liabilities are understated by $177 million, revenues are understated by $444 million, and expenses are understated by $517 million.

2. ACCOUNTING STANDARDS ARE CHANGING

Government is a complex organization with significant flows of money and transactions that can be difficult to properly account for. It is therefore essential that the accounting policies chosen to record and report those transactions reflect best practices for making the financial information understandable and for conveying the substance of what actually happened. This can be accomplished by following Canadian generally accepted accounting principles (GAAP).

In Canada, accounting standards for governments are issued by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA).

Not all transactions entered into by government are specifically covered by the accounting standards in PSAB. Further guidance, for accounting transactions not covered by PSAB, 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 GAAP.

In situations not specifically covered by Canadian GAAP, guidance on appropriate accounting policies can also 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 and with PSAB's conceptual framework for accounting standards.

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.

Reporting in accordance with Canadian GAAP should result in government financial statements that follow best practices. The financial statements should:

- 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, the way government's activities affected its net debt and the way government financed its activities; and
- demonstrate the accountability of government for the resources, obligations and financial affairs for which it is responsible.

There were no changes in generally accepted accounting principles that the government had to contend with in preparing the 2009/10 Summary Financial Statements. However, accounting standards in Canada will soon be changing.

Last year in this report we noted that it was not clear which source of GAAP that government organizations would be required to follow in the future.

In December 2009, PSAB made amendments to the introduction of the Public Sector Accounting Standards to clarify the requirements. The introduction indicates what types of government organizations are required to follow the *Public Sector Accounting Handbook* beginning next year, and it also provides direction as to the source of GAAP to be used by those organizations where the handbook is not appropriate.

While commercial GAAP is the appropriate basis of accounting for some government organizations, many others will need to review the direction and requirements in the introduction, which calls for organizations to be categorized as either:

- government business enterprises (*for example, British Columbia Hydro and Power Authority and British Columbia Lottery Corporation*);
- government not-for-profit organizations (*for example, universities and health entities*); and
- other government organizations (*for example, British Columbia Assessment Authority and B.C. Pavilion Corporation*).

Government organizations cover a variety of operations. Therefore, putting these organizations into categories enables those that are similar to use the most appropriate basis of GAAP. Accordingly:

- government business enterprises are directed to follow International Financial Reporting Standards (IFRS) beginning January 1, 2011;
- government not-for-profit organizations are directed to continue to follow standards for not-for-profit organizations in the CICA Handbook—Accounting (PSAB is proposing to incorporate these standards into the *Public Sector Accounting Handbook* in the near future); and
- other government organizations are generally directed to follow the *Public Sector Accounting Handbook* given the nature of their operations, although they are allowed to follow IFRS standards where they believe that this basis is more appropriate for the users of their financial statements.

Regardless of which choice is made, the basis of accounting determined to be most appropriate must be disclosed and applied consistently from period to period.

Several organizations in British Columbia's public sector will likely be adopting either the *Public Sector Accounting Handbook* or the IFRS standards for the first time next year as a result of these changes. As discussed under the topic of rate-regulated accounting on page 9, although most government business enterprises are directed to adopt IFRS beginning January 1, 2011, those enterprises that are defined as rate-regulated may not need to adopt IFRS until January 1, 2013.

The changeover will be a major challenge for organizations and will require a significant investment of time and resources on the part of management. This is also true for our Office as transition will mean a shift in how audit engagements will be managed, including a substantial combined effort and focus to work through solutions with management. The application of new policies and changes in the configuration of systems and the maintenance of internal controls will all have an effect on audit risk, significantly increasing the risk of errors.

The active involvement of our Office in all stages of the planning, development and implementation of government organizations' conversion processes will be critical to our audit engagements given the anticipated extent of change inherent in the process. We will need to assess the soundness and relevance of transition plans to ensure that management has identified all risk areas. In addition, we will need to understand and analyze the appropriateness of decisions, interpretations, assumptions and significant choices made when applying specific standards and accounting policies. Finally, we will need to understand the impact of the changes on information systems and accounting processes in order to determine the overall strategy and specific auditing procedures required, and the timing of their application.

The nature and extent of our involvement in the transition process will respect the need to maintain our independence in keeping with rules of the auditing profession. Therefore, we will need to define the extent of our involvement with management and communicate such involvement to audit committees.

While the changeover to new sources of GAAP is a major challenge for all of us in the coming year, it is also an opportunity for us to review our practices to ensure their efficiency and effectiveness going forward.

3. RATE-REGULATED ACCOUNTING

The purpose of rate regulation is to ensure that:

- ratepayers receive safe, reliable and non-discriminatory energy services at fair rates from the utilities; and
- shareholders of those utilities are afforded a reasonable opportunity to earn a fair return on their invested capital.

Meeting these two goals is the mission of the British Columbia Utilities Commission, which is the agency in this province responsible for administering the Utilities Commission Act.

Rate regulation not only determines the prices that a company can charge, but it also allows the company to defer and amortize over a number of years those costs that would otherwise have to be expensed in one year.

Three Crown corporations are regulated by the BC Utilities Commission: British Columbia Hydro and Power Authority (BC Hydro), the British Columbia Transmission Corporation, and the Insurance Corporation of British Columbia (ICBC). The Province includes all three in the Summary Financial Statements using the modified equity method of consolidation. Therefore any rate-regulated accounting policies used by these entities would not be conformed to the accounting policies of general government.

The net effect of rate regulation in 2009/10 has been to increase the net earnings of self-supported Crown corporations and thus reduce the annual deficit recorded in the Summary Financial Statements by $705 million (compared with $440 million in 2008/09). Note 36 of the Summary Financial Statements discloses the effects of rate regulation on BC Hydro, which makes up almost this entire total: namely, a $696 million increase in the company's net earnings in 2010 (compared with a $438 million increase in 2009). BC Hydro also holds unamortized net regulatory assets of $1,713 million. These regulatory assets are, in effect, expenses that have been deferred to future years.

The BC Utilities Commission, although independent of BC Hydro, the BC Transmission Corporation and ICBC, is nonetheless a provincial agency. Government, through the Lieutenant Governor in Council, appoints the commission's members and the government is also able to give special direction to the utilities commission that can affect the profitability of the regulated entities. This past year, we examined whether such direction is having a material impact on the earnings reported in the Summary Financial Statements. We found no indication that it is. However, in light of recent changes in accounting standards and new provincial legislation, we wish to comment on the continued ability of the Province to use rate-regulated accounting.

Under Canadian GAAP, the exemption that allowed rate-regulated enterprises to use this accounting method was removed in 2009. This means that rate-regulated entities have had to look to other jurisdictions under the Canadian GAAP hierarchy in order to continue using this principle for 2009/10. This was found in US Financial Accounting Standards Board guidance.

BC Hydro and other commercial Crown corporations are government business enterprises and as such are required by the Public Sector Accounting Board to transition to International Financial Reporting Standards (IFRS) effective January 1, 2011.

Currently, however, IFRS standards do not allow for the use of rate regulated accounting. Under IFRS, BC Hydro would have to expense many of the transactions it now accounts for as rate-regulated assets.

Very recently, there has been new uncertainty about whether or not rate-regulated entities will have to adopt IFRS on January 1, 2011 as planned. On July 28, 2010 the Canadian Accounting Standards Board issued an accounting exposure draft that may permit rate-regulated entities to continue to use current Canadian accounting standards for an additional two years. This would allow an entity, such as BC Hydro, to use rate-regulated accounting until January 1, 2013. This will allow time for standard setters to consider whether or not it will allow rate-regulated accounting under IFRS.

The provincial government recently amended the Budget Transparency and Accountability Act effective April 1, 2010 (see the following topic). Under the amended Act, the government has the ability to apply accounting principles from other jurisdictions as long as those principles are recognized by the standard-setting organization in that jurisdiction. This could result in the government choosing to use rate-regulated accounting, even beyond 2013.

4. GOVERNMENT'S RESPONSE TO CHANGING ACCOUNTING STANDARDS

At the time of writing this report government is still considering the specific impact that the changing accounting standards will have on each specific organization. The Office of the Comptroller General is consulting with organizations to determine the most appropriate basis of GAAP that each will follow under the public sector GAAP framework (see Exhibit 10 on page 36). Government organizations could follow Public Sector Accounting Board Standards (PSAB); Not-for-profit accounting standards; or the CICA Handbook (which will become International Financial Reporting Standards (IFRS) as of January 1, 2011).

It is also possible that changes in accounting for transactions by government could result from the government's amendment of its Budget Transparency and Accountability Act (BTAA). The amendment allows government to alter its interpretation of Canadian GAAP, and is in effect as of April 1, 2010.

The amended act allows the government to adopt standards of its own choosing rather than those that follow the GAAP framework provided by PSAB. If the government does so decide, it will have to choose from generally accepted accounting principles for organizations in Canada other than senior governments, or from generally accepted accounting principles applicable in a jurisdiction outside Canada that have been set by a recognized standard-setting organization in that jurisdiction.

The government has told us that the purpose of the recent amendment to the definition of GAAP in the BTAA was to ensure government was able to address potential inconsistencies or conflicts during the transition of accounting standards to IFRS. One such conflict is the question of whether or not accounting standards under IFRS would allow the use of rate-regulated accounting by companies such as BC Hydro.

Government's implementation of balanced budget legislation does not work well with accounting policies that can increase volatility in annual surplus or deficit. The inclusion of fair value accounting and the removal of rate-regulated accounting are two potential changes in accounting standards that can increase volatility.

Based on the recent exposure draft regarding rate-regulated entities that we discussed on page 9, which is likely to permit the use of rate-regulated accounting until at least January 1, 2013, government has told us that it will not be required to amend the accounting guidance of PSAB under the BTAA to address rate-regulated accounting. Government also stated that, at this stage, they have no reason to believe that any departures from the guidance of PSAB will be required during the transition to IFRS.

We will monitor whether or not government uses the legislated amendments to the Budget Transparency and Accountability Act to re-define GAAP in the provincial government reporting entity.

It is also common practice for an organization to consult its auditors when the organization is contemplating changing its accounting policies. We request that the government consult with the Auditor General before implementing any significant accounting changes.

5. WORKING CAPITAL MANAGEMENT

In last year's report we commented on the effective management of working capital. We noted that in many ways government should be run like a business. It should manage its surplus cash and investments effectively, and maintain good control over other aspects of working capital management. Collecting accounts receivable on a timely basis and ensuring that payments to suppliers are made within an appropriate time (generally 30 days after receipt of the invoice or receipt of the goods, whichever is later) is an important part of managing cash balances appropriately.

How well these working capital balances are managed can have a significant influence on borrowing requirements and the costs of servicing debt.

We are pleased to note that government's actions have resulted in a decrease in cash balances. Last year, government held over $7 billion in cash, cash equivalents and temporary and warehouse program investments at yearend. This year, the total of these has significantly decreased, from $7.3 billion to $2.9 billion. This decrease of $4.4 billion is due mainly to a reduction of $2.1 billion in warehouse program investments and a decrease of $2.1 billion in cash and cash equivalents. Although an improvement, we note that there is still a large amount of cash and cash equivalents held in the education sector – almost $1.3 billion at March 31, 2010.

Working capital management is the subject of a report that will be issued soon by our Office.

MANAGEMENT LETTERS

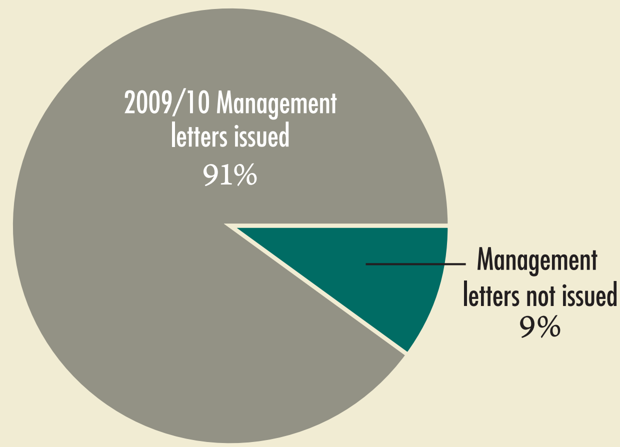
From July 2009 to June 2010, staff and contractors from our Office and from many private sector accounting firms audited the financial statements of all government entities that are included in the government reporting entity. In planning and performing each audit, consideration is given to an entity's governance and accountability, and internal control over areas such as financial management, disclosure, and information technology. Findings related to the risks identified are then brought to management's attention with recommendations, referred to as a management letter. (A standard of the Canadian Institute of Chartered Accountants is 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.

The findings presented in management letters are significant, and in the opinion of this Office they should be considered by management as soon as possible.

Our Office expects management letters to be issued to all government organizations in the government reporting entity (167 entities[2]), plus the Office of the Comptroller General. Therefore, the total number of management letters expected to be issued for 2009/10 is 168. Of those, 153 (91%) had been issued at the time we were writing this report (Exhibit 2).

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.

Exhibit 2: Number of management letters issued during 2008/09 and 2009/10



	2008/09		2009/10	
Management letters issued	151	90%	153	91%
Management letters not issued at the time of this report	16	10%	15	9%
Total	167	100%	168	100%

It is a generally accepted practice for auditors to present their management letter findings to the audit committee, with management present. It is also common for management to provide a written response to the management letter points. In this way, the audit committee has an opportunity to understand the issue from the perspective of both the auditors and management and is informed of the actions that management will take as a result of the management letter. Delays in issuing a management letter can result if an audit committee does not meet during the summer or if an auditor needs to follow up on an issue that does not impact the release of the financial statements.

These may be the reasons that not all management letters of government reporting entities in 2009/10 were released in time for us to review them for this report – although we also add that, in the interests of providing more timely information we are releasing this report two months earlier than we did last year. Still, we received 91% of the management letters this year, compared with 90% last year.

[2] The figure consists of 147 government entities (see Exhibit 9 on page 35), plus 20 ministries

MANAGEMENT LETTER ISSUES RAISED IN 2009/10

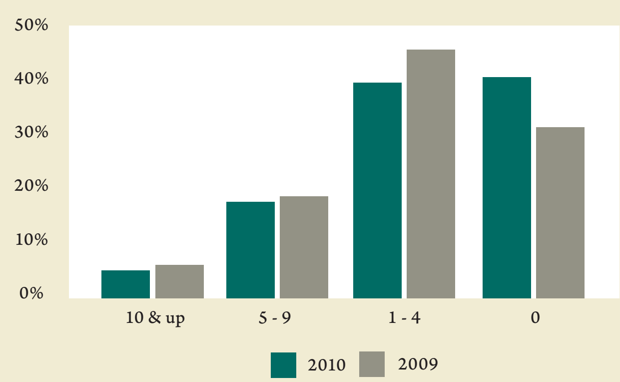
The 153 management letters issued to date for the 2009/10 fiscal year include a total of 389 issues and recommendations. Of the 389 issues, 256 pertain to new control concerns identified in the current year's audit, while the remaining 133 (34%) issues pertain to items identified in the prior year's audit that were not addressed (or were only partially addressed) by management during the current fiscal year.

Last year, we noted that of the 463 issues identified, 104 (22%) of the issues pertained to items that had not been addressed. It concerns us that management has not resolved so many issues brought forward by their auditors.

These management letter issues focus mainly on improving the areas of governance and accountability, financial management and disclosure, and information technology. We found that 121 (79%) of the 153 management letters issued contain fewer than five issues, including 61 (40%) letters where no issues were reported at all. Of the remaining 32 (21%) letters, seven had 10 or more issues (see Exhibit 3).

Exhibit 3: Number of issues in each management letter, 2008/09 and 2009/10

	2008/09	2009/10
Number of governments entities with		
10 or more management letter issues	9	7
5 to 9 management letter issues	27	25
1 to 4 management letter issues	69	60
No management letter issues	46	61
Total number of management letters issued	151	153



In last year's report we disclosed the 13 areas of control concern that arose most often in government entities' management letters. In reviewing and preparing this year's report, we note that most of last year's control concerns recur as themes in this year's management letters.

However, one of last year's themes, "Non-compliance with laws and regulations," included only one management letter point this year, therefore we have not reported it as a separate theme. For 2009/10 one additional area where control concerns were reported was added. The new theme occurring in this report is "Lack of appropriately disclosed accounting policies." Management letter concerns related to the new theme are identified under the "Financial Management and Disclosure" area.

Exhibit 4 lists the control concerns we have identified this year. These themes identify the most common control concerns noted in government entities' management letters.

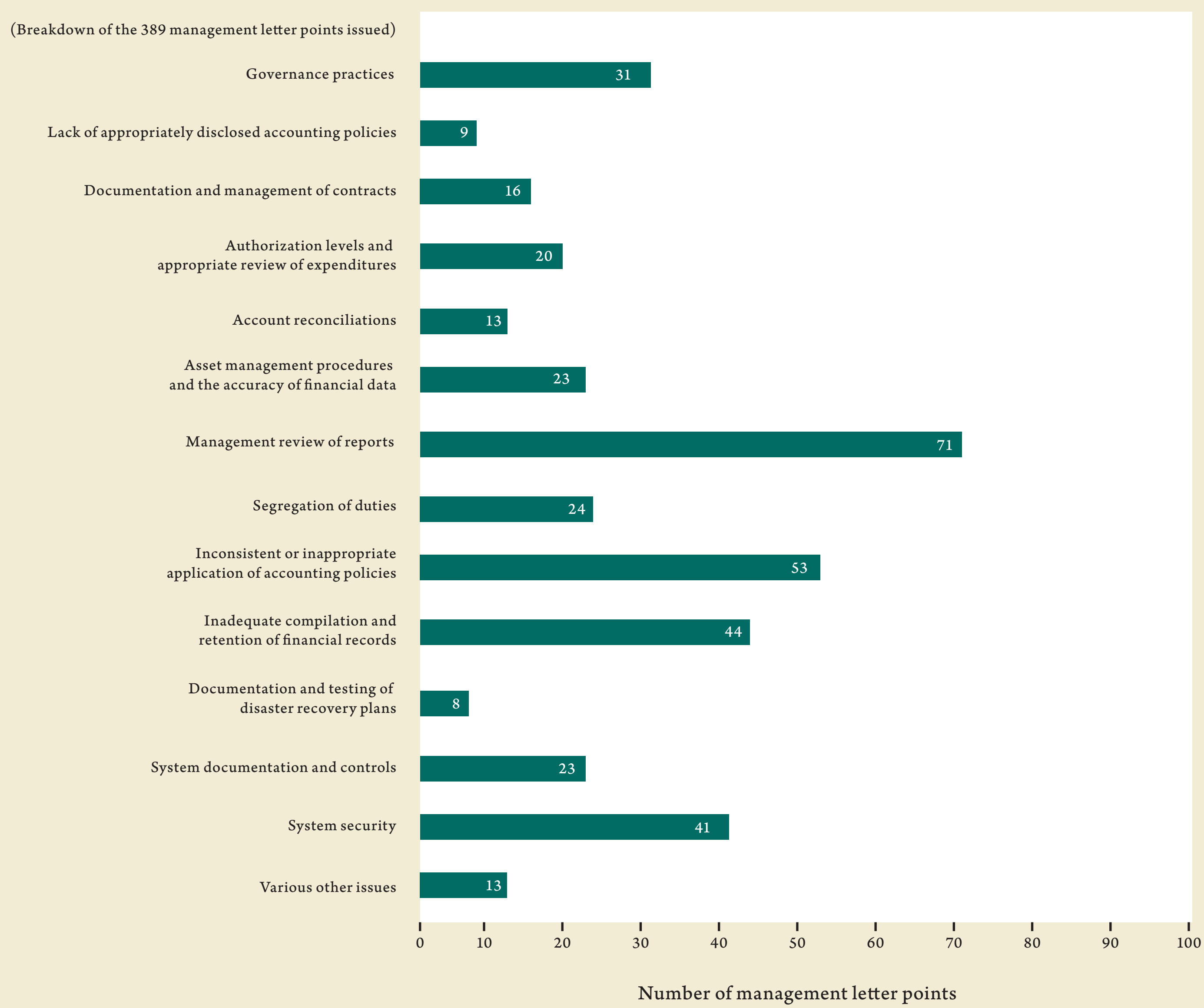
Exhibit 4: 2009/10 control concerns identified in management letters, by area

Area	2009/10 Management Letter Themes
Governance and Accountability	Governance practices
Financial Management and Disclosure	Lack of appropriately disclosed accounting policies
	Documentation and management of contracts
	Authorization levels and appropriate review of expenditures
	Account reconciliations
	Asset management procedures and the accuracy of financial data
	Management review of reports
	Segregation of duties
	Inconsistent or inappropriate application of accounting policies
	Inadequate compilation and retention of financial records
Information Technology	Documentation and testing of disaster recovery plans
	System documentation and controls
	System security

The audit process is not intended to disclose issues outside the financial statement process. Each organization therefore needs to be vigilant in conducting its own review of possible issues such as those related to our report themes of financial management and disclosure, governance and accountability, and information technology. To help organizations identify potential risk areas, we summarize below all major findings from the audits, highlighting those concerns that arose most often and have the greatest potential risk and impact. All government entities should examine these findings with a focus on improving their own controls.

Exhibit 5 shows the number of times each theme arose in the management letters.

Exhibit 5: Frequency of management letter themes, 2009/10



CONTROL CONCERNS RAISED IN MANAGEMENT LETTERS IN 2009/10

The following section presents summaries of the prevalent themes raised in the management letters that provincial government entities received during 2009/10.

Governance and accountability findings in 2009/10

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. Strong governance practices provide clear and ethical direction, anticipates risk, communicates effectively, and gives and receives feedback on performance. Weak governance is at the heart of many public sector failures and may lead to the loss of public trust.

In 2009/10 there were 31 instances, of which 12 were unresolved issues from the prior year, where governance practices issues were identified. Several issues are limiting the ability of some government entities to govern effectively. These include: policies that are not being reinforced or are missing; incomplete oversight; unclear roles and responsibilities; lack of meetings or communications; and absence of a whistle-blower program.

To operate effectively and efficiently, government entities need to have an independent functioning board of directors (or equivalent) to implement correct and complete policies, procedures and controls, and ensure that the entity adheres to them. Clearly defined roles and responsibilities must also exist and be understood.

Financial management and disclosure findings in 2009/10

Lack of appropriately disclosed accounting policies

The purpose of financial statements is to communicate information to users that is relevant to their needs. Accounting policies adopted by a government entity will affect the financial position, results of operations and cash flows, as shown by its financial statements. Accordingly, the usefulness of financial statements is enhanced by disclosure of the accounting policies. There needs to be a clear and concise description of the significant accounting policies included as an integral part of the financial statements.

In 2009/10 there were nine occurrences of lack of appropriate disclosure of accounting policies. These occurrences were due to accounting guidelines requiring disclosure of major transfers, transactions, balances, secured liabilities and accounting policy changes.

Government entities should ensure that full disclosure of information is included in the financial statements. Accounting disclosure should include those required by GAAP, as well as additional information that may be relevant to users.

Documentation and management 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 within the agreement. These discrepancies can hinder business relationships, cause inefficiencies in the overall business operations of government and lead to legal disputes.

In 2009/10 there were 16 instances, of which two were unresolved issues from the prior year, where poor documentation and management of contracts were identified. A number of issues related to inadequate contract documentation and management within many government entities. These issues included the absence of formal finalized contracts, lack of review of significant contracts to ensure accuracy and adherence to terms, and outdated, unclear and incomplete contract documentation. In addition to contracts executed with outside parties, it was noted in a few entities that internal contracts with employees were incomplete, missing or contained terms that required clarification.

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

Authorization levels and appropriate review of expenditures

Government entities implement policies and procedures to ensure that adequate control exists over the purchasing of goods and services. Not following proper authorization for expenditures mean there is greater possibility of unauthorized purchasing, overspending, and fraud.

In 2009/10 there were 20 instances, of which 10 were unresolved issues from the prior year, where improper understanding of management authorization levels and appropriate review of expenditures were identified. Deficient policies and procedures related to the authorization of expenditures in a number of government entities. The key issues were: not adhering to expenditure authorization levels; not adhering to signing authority levels; payments being made without proper authorization levels; and inappropriate documentation. The management letters pointed out that policies and reviews would assist in eliminating these issues.

Adequate review of expenditures is a control that assists in eliminating unauthorized purchases and payments. Government entities need to ensure that there are appropriate levels of expenditure authorization in place.

Account reconciliations

Account reconciliations are a strong financial and operational control. Organizations perform account reconciliations to ensure their transaction recording is complete and accurate. The absence of adequate reconciliation procedures leaves an entity susceptible to errors in financial accounts, which in turn can lead to improper representation of the operating performance, as well as erroneous future budgeting and potential for fraud.

In 2009/10 there were 13 instances, of which two were unresolved issues from the prior year, where account reconciliation issues were identified. These issues included a lack of reconciliations over accounts, and a lack of timely reconciliations and follow-up procedures for identified accounts.

Government entities should ensure that reconciliations are in place for key operational and financial accounts. The reconciliations need to be adequately structured, performed on a regular basis and reviewed by management.

Asset management procedures and the accuracy of financial data

Strong asset management procedures help maintain an organization's level of proficiency in using its assets to meet its operational needs. An organization's operational assets include inventory and capital assets. Strong control over these assets requires strict policies and procedures over ordering, warehousing, safeguarding, and financial measurement for reporting purposes.

In 2009/10 there were 23 instances, of which seven were unresolved issues from the prior year, where asset management procedures and accuracy of financial data were identified. These control concerns primarily surrounded inventory management, inventory counting and purchasing controls.

Government entities need to ensure they have adequate policies and procedures in place to enable them to effectively manage their organizational assets. Strong asset management procedures facilitate efficient use and safeguarding of organizational assets, and support accurate and complete financial reporting for these assets.

Management review of reports

Internal reports are generated to inform management of operations and helps identify errors and inconsistencies. Government has a large reporting infrastructure in place to ensure operations are efficient and effective. Lack of management review of reports creates the potential for inefficiencies, errors and fraud. Strong policies and procedures over internal reports include review and sign-off by the appropriate personnel.

In 2009/10 there were 71 instances, of which 21 were unresolved issues from the prior year, where management review of reports issues were identified. The most common themes were the lack of management review over internal reports and the deficient design of the internal report or the procedures surrounding it.

Government entities need to ensure that correct and timely report review practices are undertaken, and that report findings and recommendations are acted on in a timely manner.

Segregation of duties

Segregation of duties is one way to ensure that adequate controls are included in a financial process. Ideally, different individuals should be assigned responsibility for each critical function in each financial process. A key operational control is the segregation of duties, which is accomplished by having critical functions performed independently of one another.

In 2009/10 there were 24 instances, of which 13 were unresolved issues from the prior year, where segregation of duties issues was identified. Systems that contained these issues were of financial, payroll and purchasing types.

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

Inconsistent or inappropriate application of accounting policies

Government entities are required to follow a set of policies that dictate how information is presented and accounted for in their individual set of financial statements and for the consolidated financial statements of the government reporting entity as a whole. Accounting policies are set by each individual organization, but must adhere to Canadian generally accepted accounting principles (GAAP). This is the framework for the financial reporting process in Canada.

In 2009/10 there were 53 instances, of which 14 were unresolved issues from the prior year, where there were inconsistent or inappropriate applications of accounting policies. The most common issues reported related to the capitalization of expenditures, amortization of fixed assets, and revenue and expense recognition.

The application of consistent and appropriate accounting policies helps guide an organization in its financial reporting process and ensures that the entity is adhering to GAAP. All recommendations provided to the entities relating to deficient accounting policies need to be understood and addressed in a timely manner to ensure that financial information is complete and accurately reported in the Public Accounts.

Inadequate compilation and retention of financial records

Various policies and procedures are implemented within organizations to ensure that financial records are complete and properly retained to create an audit trail of operations. The compilation and retention of these financial records is an important ongoing control that provides evidence to verify the effective day-to-day operations of the entity.

In 2009/10 there were 44 instances, of which 10 were unresolved issues from the prior year, where inadequate compilation and retention of financial records were identified. These occurrences resulted from poor or untimely record-keeping, which can make review of transactions difficult and lead to errors or fraud.

Government entities should ensure they have good financial record keeping that will help improve efficiencies and reduce errors.

Information technology (IT) findings in 2009/10

Documentation and testing of disaster recovery plans

In the event of a major failure, emergency or disaster occurring in any government entity, appropriate procedures and documentation should be in place to minimize the loss of data and the disruption to public services. A disaster recovery plan enables the entity to plan for and structure its current resources to minimize the potential interruption to government services or loss of data. This formal document should be reviewed on a regular basis and updated whenever a significant change to the business or operating system takes place.

In 2009/10 there were eight instances, of which four were unresolved issues from the prior year, where documentation and testing of disaster recovery plans issues were identified. These control concerns came from various entities across all of government.

Government entities need to be proactive in 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.

System documentation and controls

Government entities rely heavily on information technology systems to deliver services and manage financial information. Well-developed and well-designed systems are able to control data entry and data manipulations through error checking, controls and security. In addition, a strong information technology system should be supported by clear and robust system documentation and user guides.

In 2009/10 there were 23 instances, of which 13 were unresolved issues from the prior year, where system documentation and control issues were identified. Some of the more common control concerns identified are inadequate system design and control procedures, lack of adequate system documentation to support the understanding and use of the system by its users, and a lack of review of system event logs or exception reports.

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

System security

Government entities continue to invest heavily in information technology to assist in streamlining their operations. These IT systems and services require that the information processed be correct, which in turn requires the data and the overall systems to be secure. Without complete security, there is an increased risk of incorrect or fraudulent transactions occurring.

In 2009/10 there were 41 instances, of which 17 were unresolved issues from the prior year, where system security issues were identified.

Many entities were found to have inadequate passwords (missing, for example, periodic changes and minimum length requirements). A lack of password complexity and expiration terms also increased the risk of unauthorized access to the IT system. Numerous instances of inappropriate internal user access rights were also observed and many entities were found not to have a periodic review process to check whether employee access rights to areas of the IT system have been appropriately authorized or are warranted for individual users job function. Inadequate controls over physical access to computers and the safeguarding of file server rooms were noted as well.

Government entities should follow and enforce proper and complete information technology security policies and procedures. Data contained within an organization needs to be secure from unauthorized access attempts. Management needs to continuously monitor access to IT systems from outside parties, as well as regularly review the access rights of all employees to ensure that information is not manipulated, lost or stolen.

AS PART OF OUR AUDIT of the Public Accounts for 2009/10, we gathered evidence using an online survey to better understand governance practices across the British Columbia government reporting entity (GRE). The purpose of this work was to support our financial audit, while enabling the Office to make observations on public sector governance practices across the GRE and within individual sectors.

Methodology

The survey was made up of questions drawn from good practice guidance, including our Office's recently released Public Sector Governance – A Guide to the Principles of Good Practice. As a result, our criteria were based on our good practice model, and not what is currently required by government. Entities were required to provide supporting information and documentation for many of their survey answers. To gain assurance over the information we received, we reviewed a sample of the responses. All the responses were then grouped into five sectors - ministries, Crown agencies, health authorities (and hospitals), school districts, and colleges and universities - and the results were analyzed to identify significant governance themes.

The overall response rate was 90% across the entire GRE, and ranged from a low of 81% for ministries to a high of 93% for school districts. Ministries ultimately achieved a final participation rate of 95% once three late submissions came in.

Analysis

The results of our first online survey of governance practices across the GRE provide a useful picture of governance practices in British Columbia's public sector.

Overall, the survey results were positive, with the majority of entities reporting that they use a range of good governance practices.

A summary of our key observations from the survey results follows.

Ministry responsibilities

In conducting our survey we recognized that ministries have different governance arrangements than other entities within the GRE. For example, ministries are not governed by a board of directors. Also, while some aspects of governance are the responsibility of ministries, other aspects of governance are partially or completely the responsibility of central agencies - for example, internal audit, which is performed by the Internal Audit and Advisory Services Branch, or training performed by the Public Service Agency.

Many of the specific governance roles and responsibilities of ministries are outlined in government's Core Policy and Procedure Manual. Our survey questions for ministries were tailored accordingly.

We noted that several ministry responses referred us to central agencies for governance responsibilities that the Core Policy and Procedures Manual shows as being a ministry responsibility. The most significant example was around risk management - some ministries referred to the Risk Management Branch and Government Security Office within the Ministry of Finance. We address this topic as part of our current audit of risk management.

Leadership, ethics and a culture committed to good public sector governance

Our survey results suggest that roles and responsibilities of the board Chair (or Deputy Minister in the case of ministries) were generally documented in writing and the majority of respondents stated that the board Chair (or Deputy Minister) position description is reviewed annually.

Our analysis indicated that tracking and documentation of externally provided training to board members (or ministry executive, in the case of ministries) is an area where many entities could improve.

Almost all entities reported having taken steps to ensure that board members (or ministry executive) are free from prejudice, bias and conflict of interest. However, no sector reported a regular cycle for an external review of their conflict-of-interest procedures and documents or external scrutiny of their conflict-of-interest policies. We also found that almost one-third of school districts reported that the procedures and documents relating to standards of behaviour were never reviewed by an external expert.

Stakeholder relationships (internal and external)

Our analysis revealed that some school districts and entities in the health sector were not disclosing the roles and responsibilities of the board in their annual reports or on their websites. We also noted that board and ministry executive minutes were being kept by almost all entities in the survey. One ministry responded that it did not keep minutes, and another ministry responded that this question was not applicable.

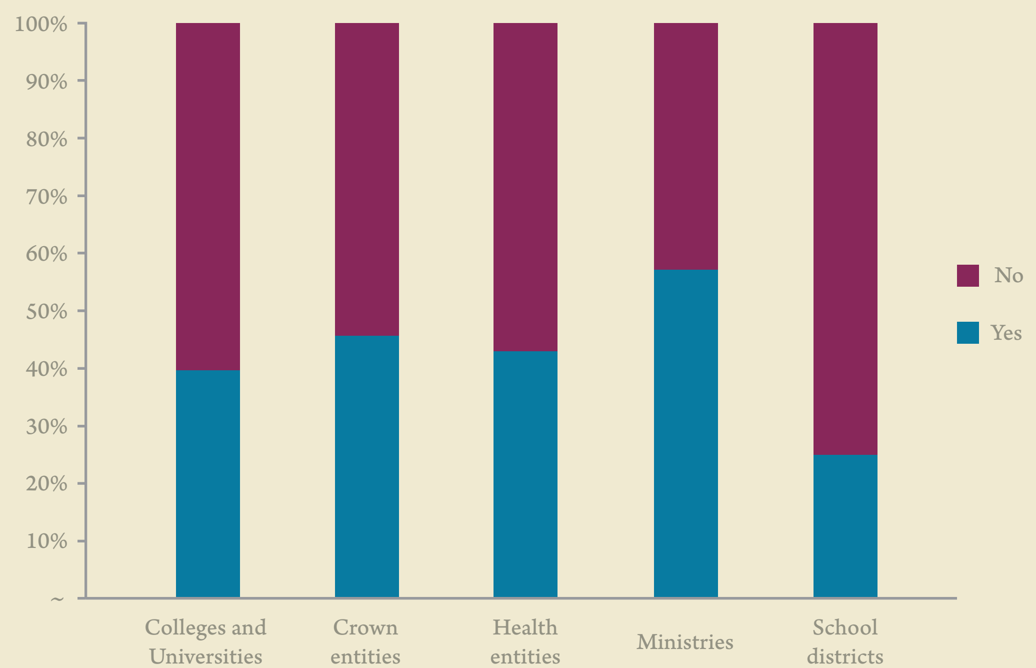
Risk management

Survey responses indicated that the majority of organizations across all sectors determine organizational roles and responsibilities for risk management and are taking steps to analyze risks for their likelihood and consequence. However, responses for entities in the health and school district sectors suggest they recognize that risk management is an area for improvement (through, for example, ensuring that risk registers are completed and risk mitigation strategies developed).

We also noted that all sectors have room for improvement in their assessment of the effectiveness of their risk mitigation strategies, with ministries scoring highest at 60%, and all other sectors at less than 50% (Exhibit 6). These results suggest that entities within these sectors are aware of the need to manage risk, but lack some of the formal disciplines available to manage it.

The Office of the Auditor General is currently conducting an audit of risk management practices in government ministries. We will use the results of that work to inform good risk management practice across British Columbia's public sector.

Exhibit 6: Has the board (or ministry executive) ensured that the effectiveness of risk management strategies are assessed?



Internal compliance and accountability

Overall, responses indicated a strong emphasis on internal compliance and accountability. However, one area for improvement is in strengthening the role of internal audit (Exhibit 7). Ministries were not asked about internal audit because it is carried out for the ministries by the Internal Audit and Advisory Services Branch within the Office of the Comptroller General.

Planning and performance monitoring

Because the board Chair (or Deputy Minister) has significant influence over entity governance that individual's performance should be assessed. Our survey found that, to ensure appropriate performance, assessment of the board Chair by the other board members (or, for Deputy Ministers, by the other members of the ministry executive) could be more frequent.

We also noted that school district documentation around performance reporting could be improved: 49% of school districts reported that the board does not have clearly documented procedures for performance reporting.

We found as well that the frequency of traditional top-down assessment of board member performance by the board Chair (or by the Deputy Minister of the executive in the case of ministries) varied from 18% for school district respondents to 100% in ministries.

With the exception of entities within the health sector, we found that fewer than half the entities in the other sectors (excluding ministries, who were not asked this question) reported that their board members assess each other's performance or that they had the effectiveness that occurs when the board is assessed by an external party (Exhibit 8).

Exhibit 7: Has the board ensured that an effective internal audit function is established?

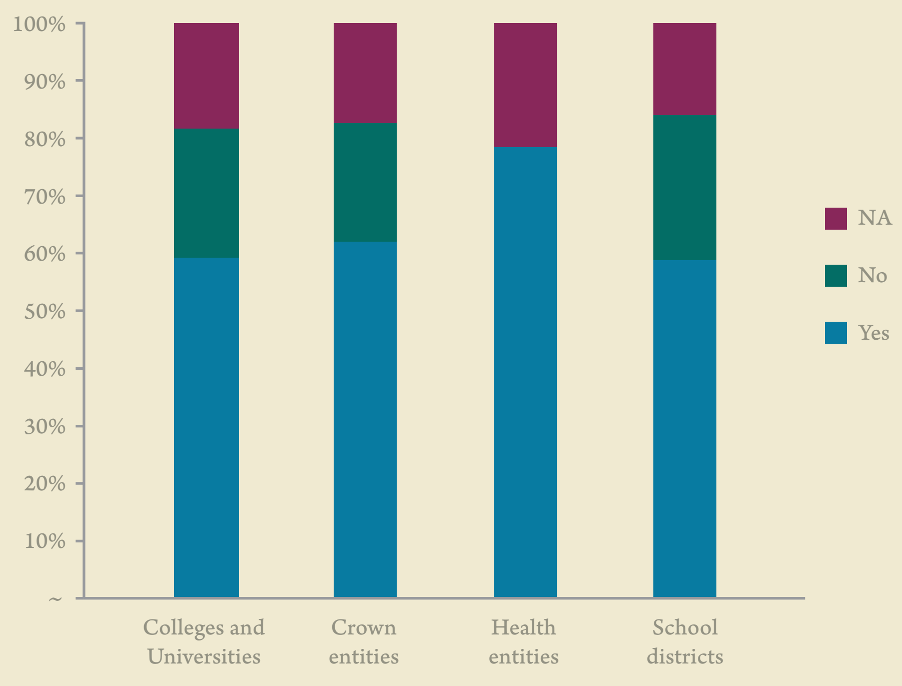
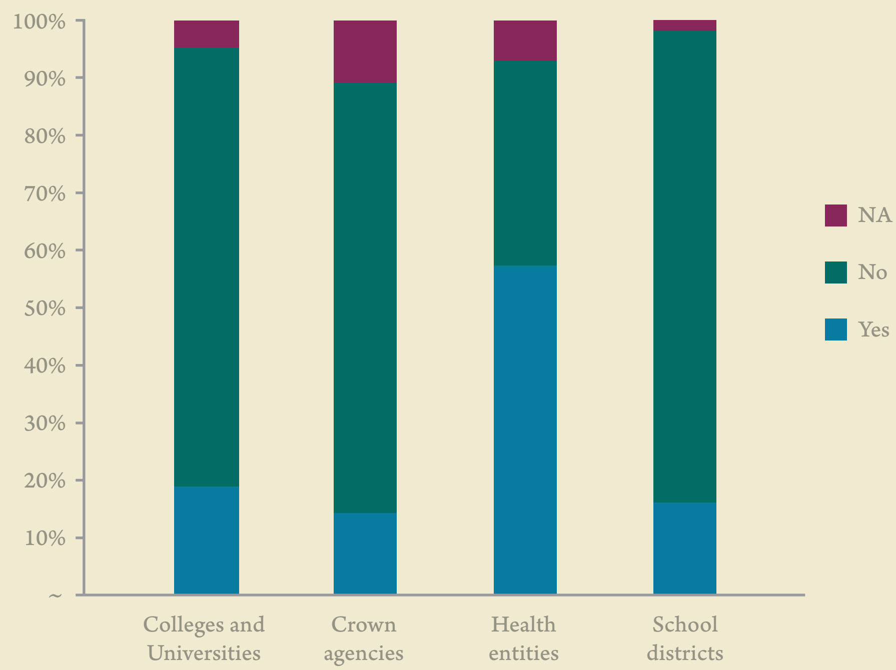


Exhibit 8: Is the effectiveness of the board in meeting its mandate formally assessed by an external party?[3]



[3] Ministries were not asked this question.

External compliance and accountability

The majority of entities reported that their boards or ministry executive is ensuring that the entity is in compliance with applicable statutory and regulatory obligations. Crown agencies and entities in the colleges and universities sector most commonly reported that this compliance review occurred annually. The remainder of sectors reported other frequencies.

Information and decision support

Almost all entities in all sectors reported that their boards or ministry executive has access to sufficient and appropriate information. This result was consistent with the results of our recent survey of board members across the government reporting entity, reported on in our December 2009 report *Making the Right Decisions: Information Use by the Boards of Public Sector Organizations.* In that survey, we found that, overall, boards in British Columbia's public sector agencies are receiving and using the information they require to fulfill their responsibilities.

COMPLETE DISCLOSURE OF PRIOR YEAR ADJUSTMENTS

When the prior year numbers in the financial statements are changed as a result of prior year adjustments, Canadian GAAP requires that the fact, nature and effect of the change be disclosed.

The government believes that it achieves this with the disclosures in note 24 of the Summary Financial Statements. In our view, however, this is insufficient and not in accordance with GAAP because it disclosed only the effect of the change on the prior period equity balance or on the prior year surplus or deficit; it does not fully explain the nature of the change.

For example:

- The note discloses that the opening accumulated surplus for 2010 has been decreased by $116 million to restate the Health Benefits Trust liability, but nowhere is there an explanation as to why this restatement is needed, nor is it disclosed that accrued liabilities at March 31, 2009 have been increased by $116 million.
- The note discloses that there has been a change in the accounting policy used by the University of British Columbia (UBC in the note) to account for the Canadian Foundation for Innovations, and the impact on the opening accumulated surplus for 2010 is to reduce it by $12 million. However, there is no disclosure of the $24 million decrease in tangible capital assets at March 31, 2009, or of the $10 million increase in accounts payable and the $22 million decrease in deferred revenue as of that date.

As well, sometimes the adjustments made to the prior year numbers have no impact on equity, so there is no disclosure of them in note 24. This year, for example, prior year accounts payable have decreased by $18 million and deferred revenue has increased by $22 million, while fee and licence revenue reported for the prior year has decreased by $13 million, investment income has increased by $13 million, other expenses have decreased $17 million and interest expense has increased $17 million.

RECOMMENDATION #1 ***We recommend that, when prior year numbers have been restated, government draw attention to the restated numbers with appropriate referencing and make full disclosure of the changes that have taken place, in accordance with Canadian generally accepted accounting principles.***

MINISTRY FINANCIAL STATEMENTS

All government organizations in British Columbia prepare separate financial statements, however individual government ministries do not prepare separate financial statements. This is the practice in other provinces, except Alberta, where ministry financial statements are prepared.

In our view, separate financial statements for individual ministries would improve the government's accountability. The ministry results for the year could be compared to budgeted amounts. This would enhance the validity of the performance measures currently included in each ministry's service plan reports.

In addition, if financial statements were prepared on a consolidated basis, including the organizations each ministry is responsible for, these financial statements would give a more complete picture of the sector and thus allow a better understanding of the performance and financial management in the sector.

We note that the Public Sector Accounting Standards Board (PSAB) currently has a project underway related to entity level financial statements. The objective of the project is to issue an accounting standard that addresses recognition and measurement criteria and presentation and disclosure issues that are unique to departmental, ministerial or other entity-level general purpose financial statements. We note that PSAB does not intend to require the issuance of entity level financial statements by governments or government entities, but is providing this guidance for those that choose to prepare these statements. In our view, however, this practise should be adopted as has been done by Alberta.

RECOMMENDATION #2 ***We recommend that government require individual ministries to prepare separate financial statements, and also prepare consolidated financial statements showing the financial results of the sectors they are responsible for.***

ACCOUNTING FOR FIRST NATIONS SETTLEMENT COSTS

Treaty negotiations between the Province, Canada and First Nations have been ongoing since the BC Treaty Process was established in 1992. Treaty negotiations are multi-stage processes that culminate 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.

The final sequence of events leading up to a treaty is as follows:

- The negotiators for the three parties reach a final agreement and initial it.
- The First Nation votes on ratification.
- If the agreement is ratified, then the Province passes legislation to authorize the government to sign the agreement.
- The First Nation, the Province and the federal government sign the agreement.
- The federal government passes legislation.
- The Final Agreement is implemented (for example, Orders-in-Council are passed to bring the legislation into force) and the treaty goes into effect.

Currently six First Nations in British Columbia are negotiating final agreements.

In our report on the 2008/09 Public Accounts, we discussed the need for government to continue to review its accounting policies related to settlements with First Nations. At issue is when the Province should recognize its liabilities arising from a treaty.

Last year we asked the government to give accounting recognition to the Maa-nulth treaty as at March 31, 2009. The Province declined to record this transaction, a decision that resulted in liabilities and expenses being understated in the Summary Financial Statements by $27 million. We did not qualify our 2009 audit opinion for this omission because we determined the amount of error remaining in the financial statements was not material.

Government reviewed the accounting for First Nations settlement transactions last year and has taken the position that no liability can arise until the federal parliament has passed the legislation, since only the federal parliament has the authority to enact a treaty and the Province cannot be liable for something that does not yet exist. Thus, the Province has concluded that the cost of settlement agreements with First Nations should be recognized in the financial period that the Final Agreement is ratified by all parties.

We continue to disagree with this conclusion. In our view, the liability arises at the date the Province signs the final agreement. Although the federal parliament may not yet have passed the enabling legislation, under Canadian GAAP the liability exists because the province cannot unilaterally decline to fulfill its obligations under the agreement.

RECOMMENDATION #3 ***We recommend that the provincial government again review its accounting policy with respect to the settlement of First Nations transactions to ensure the policy is in accordance with Canadian GAAP.***

ACCOUNTING FOR INHERITED CROWN LAND

Although not a topic that had much prominence during the audit of the 2009/10 Summary Financial Statements, accounting for land has been the subject of discussion between this Office and the Office of the Comptroller General for several years. Accounting for land has improved over the years; however there are still disagreements over the proper recognition and accounting methods to be used when accounting for land.

Government first began to capitalize land – that is, recognize land as an asset – in the mid-1990s. Since that time government has recorded land that it has purchased or otherwise improved. This includes land under resource roads, highways, buildings, parks and other non-depreciable land parcels. However, land inherited by government is not recognized by government in its financial statements. This is in keeping with Canadian GAAP, which states that lands inherited by the Province of British Columbia (meaning 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 (for example, for use by municipal governments as parkland or for other services). 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. Accordingly, government values the land and recognizes its existence and its disposal in its financial statements.

While we agree with recognizing the land, we disagree with the way in which government is accounting for that recognition – namely, by recording 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. 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 a position after having disposed of the Crown land. However, the effect of the free Crown grant is that the government has given away something of value -- it has fewer assets than it did before the transaction occurred.

Revenues (including gains) are defined by Canadian GAAP 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.

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.

In recent years, the amount of land used in transactions has not been material, and so we have made no reference to these differences in our audit report.

RECOMMENDATION #4 ***We recommend that when inherited Crown land is valued, the change in value be recorded in accordance with Canadian GAAP as a credit to accumulated surplus/(deficit) and not to revenue.***

CLASSIFICATION OF DEBT

Government reports debt in the Summary Financial Statements and in the Provincial Debt Summary as either taxpayer-supported or self-supported.

The distinction between the two types of debt is important to government, as self-supported debt is generally repaid through the profitable activities of government business enterprises. In fact, all of the province's debt must be repaid from government's overall resources – government does not budget its debt repayment or annual expenses based on whether the cash available is from taxes, borrowing or some other source.

However, given that government does disclose its debt in this manner, it should at least classify the debt properly.

Last year in this report we recommended that government's warehouse debt should be classified as taxpayer-supported debt rather than self-supported.

Warehouse debt is a government program that takes advantage of market opportunities to borrow in advance of future requirements. These funds are invested until they are needed by the government or its Crown corporations and agencies.

At March 31, 2009, for the first time in a number of years, there was warehouse debt outstanding at the year-end. It totalled $2.1 billion. Although there was no warehouse debt outstanding at March 31, 2010, the 2009 balance remains incorrectly recorded in the Summary Financial Statements, and the debt will continue to be recorded incorrectly for three more years in the five-year Provincial Debt Summary schedules.

The government has stated that including warehouse debt with self-supported debt is reasonable because, as the funds borrowed are invested, the investment returns fund the interest payable on the debt.

In our view, the warehouse debt would be more appropriately disclosed as taxpayer-supported debt. It is rare that the investment earnings are more than the expense, and so there is a net carrying cost that gets passed on to whichever organization the debt is allocated to. This means the warehouse debt is not completely self-supporting. As well, the warehouse debt is often allocated for use by central government or by government organizations that are not self-supporting.

Of the just over $2 billion in warehouse debt outstanding at March 31, 2009, $1.2 billion was allocated for use by central government or by other taxpayer-supported organizations and $0.8 billion was loaned to self-supporting entities.

For fiscal 2009/10 and 2008/09, the audit opinion on the Summary Financial Statements has been qualified with respect to the classification of the Transportation Investment Corporation (TIC) as a government business enterprise. A secondary outcome of the TIC being incorrectly classified as a government business enterprise is that the debt is classified as self-supported rather than taxpayer-supported.

While the TIC's debt was only $20 million as at March 31, 2009, it was $544 million a year later in March 2010. As construction of the Port Mann Bridge and related projects occurs over the next few years, the TIC's debt is expected to rise to more than $3 billion. This may prompt our Office to qualify our opinion on the Summary Financial Statements and the audited schedules in the Provincial Debt Summary.

Including warehouse debt and debt of the TIC as self-supported debt also skews the performance measures included in the Provincial Debt Summary. The performance measures are broken down between self-supported measures and taxpayer-supported measures. The lower the taxpayer-supported debt, the better the measures appear.

RECOMMENDATION #5 ***We recommend that the debt of the warehouse borrowing program and of the Transportation Investment Corporation be included with taxpayer-supported debt and not self-supported debt.***

DISCLOSURE OF 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 (public-private partnership) 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's contractual obligations are disclosed in note 25(d) of the Summary Financial Statements. These are not small amounts. The Province is committed to purchasing more than $53 billion in goods and services as at March 31, 2010.

Government is meeting the minimum Canadian GAAP requirements with respect to disclosing the nature of contractual obligations by disclosing in the Summary Financial Statements the amount of obligations by sector. Beginning last year, government now also provides a reference to some more detailed information, outside of the Summary Financial Statements.

However, in our view financial statements should stand on their own – meaning the statements themselves should provide enough information for the reader to be able to evaluate the impact of the contractual obligations on the future financial performance of government. It would therefore be helpful if more detailed information on the contractual obligations were included within the Summary Financial Statements.

Government could improve its disclosure of contractual obligations in the Summary Financial Statements by providing a comparative amount for the total column and giving additional details of the types of obligations. This would be in keeping with Canadian GAAP objectives for financial statements – namely, that information provided in the financial statements should be useful for evaluating the government's ability to finance its activities and to meet its liabilities and contractual obligations, and for evaluating government's ability to provide future services.

For example, in the schedule of contractual obligations is a contract for provincial policing that obligates the Province to $284 million in 2011 and $276 million in 2012. Nothing is listed beyond 2012. This leaves it unclear as to whether or not the government intends to continue providing these services and incurring similar expenses into the future.

In previous reports, we have also suggested 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 for readers to assess the impacts of the two types of commitment in future years.

RECOMMENDATION #6 ***We recommend that government include additional information about the nature of the contractual obligations in the Summary Financial Statements.***

For disclosure purposes, the Province has assessed "significant contractual obligations" to mean those over $50 million. This threshold should be removed or at least reduced when government is gathering contractual obligation information from entities. In our view, only after all contractual obligation information has been gathered from all entities 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 #7 ***We recommend that government use a lower cut-off for collecting and assessing the disclosure of contractual obligations in the Summary Financial Statements.***

PENSION PLAN DISCLOSURES

We have reported in previous years, and continue to report, that government is not in full compliance with the Canadian GAAP disclosure requirements in the Summary Financial Statements for its public sector employee pension plans. Particular items that continue not to be disclosed include the:

- market value of plan assets at the beginning and end of period;
- current period benefit cost (current year expense);
- components of the retirement benefits interest expense for the year; and
- amount of benefits paid during the year.

In prior years, all four of the Province's statutory pension plans were in an accounting surplus position. Because provisions in the plan stipulate that government has no formal claim to surpluses, there has been no recognition in the statement of financial position for the net asset position of the plans.

This year, three of the plans – Public Service, Municipal and College – continue to be in surplus positions. However, based on the most recent actuarial valuation of the Teachers' Pension Plan (December 31, 2008), that plan has moved into an accounting deficit position of $100 million. Under the terms of the pension plan, the Province is responsible for 50% of any obligations. Therefore, included in the Summary Financial Statements this year is a liability of $50 million for the Teachers' Pension Plan.

RECOMMENDATION #8 ***We recommend that government improve its disclosure of pension plans as required by Canadian generally accepted accounting principles.***

THE GOVERNMENT REPORTING ENTITY — WHAT'S IN AND WHAT'S OUT?

One of the first questions governments must answer when creating their consolidated financial statements is: *which entities should be included in the financial statements?*

The composition of the government reporting entity is one of the most important aspects of the Summary Financial Statements. The inadvertent exclusion of an entity from being consolidated could cause the financial statements to be materially misstated. As well, as described on page 35 of this report, government must also determine *how* an organization is to be consolidated. There are three options: a line-by-line (full) consolidation method as is done for most government organizations; a modified equity method as is done for government business enterprises; and a proportionate line-by-line consolidation method as is done for Canadian Blood Services, the government's sole government partnership.

Only since 2004/05 has British Columbia consistently consolidated the SUCH sector – schools, universities, colleges and health entities – into the Summary Financial Statements. For several years leading up to 2004/05, the Auditor General had qualified his audit opinion on the Summary Financial Statements because of the exclusion of the SUCH sector from the government reporting entity.

The government reporting entity should include all entities that are controlled by government. In practice, it is not always clear whether or not an entity is controlled. Asking if control exists does not always generate a simple yes or no answer because there are varying degrees of control that can be present. However, in the end, control is a question of fact.

As well, government does not have to exercise control; it just needs to be able to control the organization. This can create a situation where it seems that government does not control an organization, but then it will take an action that demonstrates that in fact it does have control after all. In this respect it is important to make the distinction between the ability of the government to control an organization, and the ability of government to introduce and pass legislation that will give government control.

In considering whether an organization is controlled, we look at the power that existing legislation gives to government. In the case of BC Ferries for example, the fact that the government introduced legislation in spring 2010 to limit the amounts paid to the board of directors does not indicate that the government has control over the corporation. But whenever legislation such as this is introduced, we revisit the issue of control over the organization affected.

The organizations that make up the government reporting entity can change each year as new organizations are created or dissolved or as government removes itself from governing boards.

The Shared Services Organization Administration Society in the health sector is a new organization that has been included in the Summary Financial Statements for the first time this year. Also in the health sector, the government has created the British Columbia Heath Services Purchasing Organization. It will be consolidated when it starts to operate in 2010/11.

Sometimes an organization will come to our attention, or to government's, that was created some years previously but was overlooked. This was the case with the BC Academic Health Council. Given that the council is governed by public sector employees from health authorities and post-secondary education institutions as well as government ministries, the organization is clearly controlled by government. It has been included in the consolidation this year.

Not included in the consolidated financial statements even though they are controlled by government are the four employers associations set up following the 1992 Korbin Commission - one each for the health, post-secondary, schools and social services sectors. Legislation states that:

- these associations must comply with any strategic direction issued by the Public Sector Employers Council (which is under the purview of the Ministry of Advanced Education);
- the associations' constitutions and bylaws must be approved by the Minister and must be changed if the Minister requests it;
- a public administrator can be appointed; and
- the Minister's approval is needed for any borrowing.

These four organizations should have been included in the Summary Financial Statements, but they were not. If these associations had been consolidated, financial assets would have been increased by approximately $35 million, liabilities by $30 million, non-financial assets by $2 million, equity by $7 million, and revenues and expenses by $9 million. The omission of these entities was not enough to cause us to provide a qualification of the audit opinion on the Summary Financial Statements.

A number of changes in the government reporting entity also occurred immediately after the year-end. These changes will be reflected in the fiscal 2010/11 Summary Financial Statements:

- The Clean Energy Act, tabled on April 28, 2010, consolidates BC Hydro and BC Transmission Corporation into a single organization.
- Tourism British Columbia was dissolved effective April 1, 2010, and all rights, property and assets were transferred to the Ministry of Tourism, Culture and the Arts. We do not expect Tourism British Columbia to report as a separate entity in fiscal 2010/11.
- The Homeowner Protection Office ceased to operate on April 1, 2010, and its assets and liabilities were transferred to the Minister of Finance and the BC Housing Management Commission. We do not expect the Homeowner Protection Office to report as a separate entity in fiscal 2010/11.
- As of April 1, 2010 the British Columbia Railway Company became a subsidiary of the BC Transportation Financing Authority (BCTFA). We expect that BC Rail will not be a separately reported government business enterprise in fiscal 2010/11, but instead will be fully consolidated within the financial statements of BCTFA.

INCLUSION OF UNIVERSITIES IN THE GOVERNMENT REPORTING ENTITY

In the February 2010 Throne Speech government announced that, "Legislation will be introduced enabling our universities to remove themselves from the government reporting entity. We cannot let accounting policy stand in the way of our students' interests or hold our universities back from pursuing their unique areas of excellence in partnership with others."

Under current British Columbia legislation the government must prepare its financial statements in accordance with generally accepted accounting principles (GAAP). Under GAAP, those entities that are considered to be *controlled* by government are included in the government reporting entity – that is, included in the Summary Financial Statements. Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities. This is a question of fact, and to determine whether control exists a number of accounting indicators of control are assessed.

For universities to be excluded from the government reporting entity, the relationship between government and universities would have to change such that universities are no longer controlled by government. This would require changes to the current accountability relationship that exists between the two parties. We understand that government is currently considering whether the current governance and control framework is appropriate for universities, or if changes should be made.

While it is government's prerogative to make such change, financial reporting under GAAP looks at the substance of the relationship between government and other organizations, not just the legal form.

If legislation was introduced to exclude universities from the government reporting entity, but under GAAP the universities were still considered to be controlled by government, then their exclusion from the Province's Summary Financial Statements would be a departure from GAAP, and would result in a reservation in our audit opinion.

Universities are a significant component of the Summary Financial Statements. In government's Public Accounts, the unaudited "SUCH Statement of Financial Position" discloses that universities have an accumulated surplus of $5,043 million as at March 31, 2010, which is included in government's financial statements ($4,789 as at March 31, 2009). Removing universities from the government reporting entity would have the effect of reducing the $5,272 million of accumulated surplus recorded in the Summary Financial Statements as at March 31, 2010 ($6,572 million as at March 31, 2009).

The "SUCH Statement of Operations" discloses that universities had a surplus of $254 million in fiscal 2009/10 (compared to a deficit of $89 million in 2008/09). The three largest universities (University of British Columbia, University of Victoria and Simon Fraser University) accounted for $200 million of the surplus in 2009/10 (and $105 million of deficit in 2008/09).

Assuming government continues to require balanced budgets in the future, any surpluses foregone by government by not consolidating the universities will have to be made up by other organizations.

As well, if universities had left the government reporting entity in 2009/10 the impact to the Summary Financial Statements annual deficit may have been even greater because any capital grants given to the universities would have been expensed rather than recorded as assets. This impact would be reduced by the amount of amortization expense in the universities.

OUTSOURCING OF GOVERNMENT OPERATIONS AND THEIR IMPACT ON THE AUDIT

The provincial government has been outsourcing significant processes for several years, entering into agreements with private or public-owned companies to run some of government's operations. For example Medical Services Plan operations are now operated by a company called Maximus, and the Ministry of Finance has outsourced revenue management operations to a company now called Advanced Solutions, An HP Company (HPAS).

As part of the provincial audit process, auditors are required to understand and document government operations that result in significant dollar amounts or disclosures in government's financial statements. Auditors examine the systems to ensure no known problems exist with the accuracy of information included in the financial statements. Auditors can obtain this assurance either from our own examination of the system or from a report by another auditor that verifies the system is working as intended.

Government should also be interested in ensuring that the outsourcing companies have adequate controls in place to run public sector operations accurately and effectively. A lack of appropriate controls or a breakdown in operation of those controls can put the Province at risk of facing, for example, inappropriate access to information, service interruption, or inaccurate processing.

In the case of having contracted with Maximus and HPAS, for instance, the provincial government has hired an independent firm of chartered accountants to provide what is known as a "service auditor's report" over each system's environment and the design and effectiveness of its processing controls.

On March 30, 2009 the Ministry of Citizens' Services outsourced management of its core government information system environment to HPAS. The company is tasked with managing the operating environments that process significant and sensitive core government applications and data.

In an outsourcing situation such as this, where control over significant assets and sensitive information has been entrusted to a third-party, it is critical to ensure that adequate controls are in place and operating effectively over the term of the contract. As the steward of public resources and data, the provincial government is responsible for ensuring the privacy and accuracy of the data being processed by any of its contracted companies.

We found, however, that in this first year of the Ministry of Citizens' Services' contract with HPAS, government did not obtain assurance over the company's control environment. We have recommended that the ministry obtain, as soon as possible, an annual service auditor's report to provide assurance that the outsourced system is operating as intended.

We add that our Office and the Office of the Comptroller General have recently discussed the possibility of government's Internal Audit and Advisory Services (IAAS) branch taking on responsibility for assessing some outsourced systems and providing service auditor's reports on those systems.

This approach could save the government money, as the audits would be completed by IAAS employees rather than by independent accounting firms. However, because of the lack of independence between IAAS staff and government, we would need to perform additional audit procedures before the Auditor General could rely on the service auditor's reports. We will continue to discuss with government the possibility of IAAS issuing service auditor's reports and our ability to rely on them.

ACCOUNTING FOR DEBT USING EQUITY ACCOUNTING

We have encountered provincial government organizations, such as universities, that invest in subsidiary companies. When the subsidiary is consolidated into the parent organization its financial results may be recorded using the equity consolidation method of accounting. This means that while the ending equity and annual income of the subsidiary is reflected in the parent's financial statements on a net basis, the gross revenues, expenses, assets and liabilities are not.

Any debt that is borrowed by the Province and re-loaned to a government entity through the Province's fiscal agency loan program is recorded as debt in the Summary Financial Statements. This debt is legally in the name of the Province which in turn lends it to an agency, such as a health authority.

However, when a subsidiary that is consolidated into its parent using the equity method does not borrow through the Province's fiscal agency loan program, the debt is not recorded in the Summary Financial Statements.

We have noted in some post secondary institutions that an ancillary operation, such as the management of investment property, may be organized as a department of the institution or as a separate legal entity based on various factors such as whether or not it will incur debt. If an operation is run as a separate legal entity, then the organization may be able to consolidate it using equity accounting, and this will result in debt not being disclosed in the Summary Financial Statements.

Organizing an operation as a separate legal entity rather than as a department within an institution incurs certain costs. As well, a separate legal entity may not have as good a credit rating as the Province and therefore their costs of borrowing may be higher. This is an area we will continue to monitor and we may in future review business cases for significant restructuring to consider whether value for money was achieved.

Note that all government debt, whether or not incurred directly by an organization accounted for by the equity consolidation method, is captured in the Provincial Debt Summary. The Provincial Debt Summary is an audited report in the Public Accounts that lists all the debt of the Province, including mortgages, capital leases and debt guaranteed on behalf of others.

We also discuss the disclosure of debt, as either taxpayer-supported or self-supported, on page 25 of this report.

ACCOUNTING FOR IMPAIRED INVESTMENTS (CHILDREN'S EDUCATION FUND)

The impairment of investment values was a topic of discussion in many government organizations during 2008/09. The drop in value of the stock market and the resulting "credit crunch" caused investment losses in many government organizations.

One of the accounting issues we encountered last year was related to ensuring that investment losses were reported on a consistent basis across government. Investments are held within the Consolidated Revenue Fund and in universities, health authorities and many other government organizations.

Long-term portfolio investments are carried at cost (book value) in the Summary Financial Statements. Unless the investment market value has declined below cost and the impairment is considered to be other than temporary, then no adjustment should be made to the recorded value. Some judgement is required to determine whether or not the long-term investment value is impaired.

Last year only a few long-term investments were deemed to be impaired in the Summary Financial Statements. $38 million in asset-backed commercial paper (ABCP) was considered impaired and written down in 2008/09, as well as $2 million held in Lehman Brothers bonds. We agreed with the write down of those investments.

However, a $19 million impairment expense in the Children's Education Fund was also recorded, which we did not agree with. We did not qualify our 2009 audit opinion for this because we determined the amount of error remaining in the financial statements was not material.

The Children's Education Fund is a pool of investments set aside to fund post-secondary education scholarships for children recently born or adopted in British Columbia. The investments would not be required for about 15 years, when the first eligible children graduate from high school.

Although there were many other investments across government last year whose market value was less than book value, only the three investments noted above were written down by government. Therefore the write down of the Children's Education Fund was not done on a basis consistent with government's other investments.

When this investment was written down last year, the market value was $69 million and the book value was $88 million – thus showing an unrealized loss of $19 million. As of March 31, 2010 the market value had more than recovered from its prior year unrealized losses. The current book value of investments, which is the amount recorded in the Summary Financial Statements, is $117 million, while the market value is $138 million – thus now showing an unrealized gain of $21 million.

This supports our view that this investment was written down in error in 2008/09, and in the current year a retroactive restatement of the Summary Financial Statements should have been made to correct the writedown.

ACCOUNTING FOR PAYMENTS FOR THE 2010 OLYMPIC SECURITY COSTS

Last year there was much public discussion over the cost of security for the 2010 Olympic and Paralympic Winter Games.

When the government first prepared its budget for the Games, the security costs were to be split 50/50 with the federal government. British Columbia's share was estimated at $87.5 million.

Amidst media reports that the security costs might reach $1 billion, British Columbia renegotiated the security agreement. In January 2009, Canada agreed to assume responsibility for the security costs, in return for which British Columbia agreed to pay the balance of the $87.5 million to Canada by March 31, 2009 and to forego $165 million of infrastructure funding that it would otherwise receive from Canada.

Nevertheless, this $165 million was still, in substance, a payment for Olympic security costs. Accordingly, the provincial government added it to the total commitment disclosed in note 25(c) of the Summary Financial Statements.

In our comments on this issue last year, we expressed our concern over the uncertainty for how the $165 million would be accounted for by government. We can now report that government correctly expensed the $165 million in 2009/10, and removed the amount from the commitment total in note 25(c).

As at March 31, 2010, $32 million has been incurred in infrastructure costs that would have otherwise been claimed from the federal government. The remaining $133 million in related infrastructure costs is expected to be incurred, and payments from Canada forgone, over the next three fiscal years. The $133 million is included in accounts payable as at March 31, 2010.

CARBON NEUTRALITY

In 2007 the provincial government passed the Greenhouse Gas Reduction Targets Act. A requirement of that Act is that each public sector organization be "carbon neutral" in each calendar year beginning with 2010. Carbon neutrality involves measuring operational greenhouse gas emissions, reducing those where possible, and offsetting the remainder through the purchase of carbon offsets.

In March 2008 government created a new Crown corporation called the Pacific Carbon Trust (PCT). The purpose of PCT is to acquire greenhouse gas offsets on behalf of the Government of British Columbia, all other public sector organizations to which the Greenhouse Gas Reduction Targets Act applies, and any other public agency, company or individual resident in British Columbia who the trust has agreed to serve.

To achieve carbon neutrality each year, government will need to be confident both in the emission figures reported by government ministries and organizations and in the quality of the carbon offsets purchased to apply against those emissions. If there are errors in the calculation of emissions, or if there are issues with the quality of carbon offsets acquired, government's goal of carbon neutrality may not be achieved or may not be verifiable.

Carbon offsets are a relatively new creation. They are a vehicle for private and public sector organizations to ensure that their overall carbon emissions stay within certain pre-determined levels. In effect, this allows organizations to pay for the excess carbon emissions they produce by purchasing what are known as "green" carbon credits, or carbon offsets.

Given the emerging nature of the market we view the procurement of carbon offsets to have inherent risks that necessitate a robust procurement process to ensure quality is sufficient. Over the next few years, our Office plans to conduct work to assess the risks with respect to both the reporting of emissions and the procurement of carbon offsets.

ACCOUNTING FOR THE HST TRANSITIONAL ASSISTANCE FUNDING

During the year, the Province entered into an agreement with the federal government to replace the current provincial sales tax and federal goods and services tax with a harmonized sales tax (HST).

As a result, the federal government agreed to provide transitional assistance to British Columbia, a total of $1,599 million: $250 million to be paid within seven days of the Province tabling legislation to wind-down the provincial sales tax; $769 million to be paid on the first business day after the implementation of the HST (July 2, 2010); and $580 million to be paid one year later, July 2, 2011, provided that on the due dates the Province is not in material breach of the agreement.

The legislation to wind up the provincial sales tax was tabled on March 30, 2010, and the first installment of $250 million was recorded as revenue in the 2009/10 fiscal year. The federal government made the payment on April 1, 2010, and so the amount was a receivable at the year-end. The Province has budgeted to receive the remaining installments in the 2010/11 and 2011/12 fiscal years.

The transitional assistance funding is repayable if the Province is in a material breach of the agreement. What constitutes a material breach is not defined in the agreement. However if the federal government considers that the Province has materially breached the agreement, it is required to discuss the issue before formally giving written notice of the breach. After notice has been given, the Province has six months to remedy the situation or it has to repay whatever amount of the transitional assistance funding it has already received.

The penalty for being in a material breach lasts for five years. After that time, either the federal government or the Province can issue a notice of termination, to be effective no sooner than 18 months after it is issued, at which point the HST agreement would be terminated with no further penalty.

ACCOUNTING FOR BONUS BID REVENUE

One of the issues discussed this year that resulted in a prior period adjustment of the Summary Financial Statements is the accounting for bonus bid revenue. Most of the petroleum and gas rights in British Columbia are owned by the Province. Bonus bid revenue arises from the monthly auction of these rights in the form of tenure agreements, giving access to specific parcels of land. Typically, tenure agreements are for 3-10 years, can be renewed or extended, and can also be divided. The government records these tenures, and any changes to them, in its Petroleum Title System.

Before 2005, bonus bid proceeds were recognized as revenue when received. However, since 2005, the Province has deferred and amortized these proceeds over the average life of the tenures, in accordance with Canadian generally accepted accounting principles (GAAP). In 2005 an average tenure life of eight years was adopted based on tenure data from April 1, 1990 onward.

In fiscal 2009/10, the government developed a method to more easily extract data from the Petroleum Title System and calculate the average life of a tenure agreement. In our review of the new calculation method and the underlying data, we concluded that although the data before April 1, 1984 was not complete there was no reason to exclude tenures between then and March 31, 1990. When these tenures are included in the calculation, the tenure life average increases from eight to nine years.

The government recalculated the amortization of bonus bid revenue using the nine-year average life. The government correctly restated the prior year figures in the Summary Financial Statements. The effect of the change was to decrease 2009/10 revenue by $61 million and to decrease 2008/09 revenue by $41 million. Deferred revenue (revenue that will be recognized in the future) increased by $318 million in 2009/10 and increased by $257 million in 2008/09.

LONG AMORTIZATION OF TANGIBLE CAPITAL ASSETS

Tangible capital assets consist of schools, hospitals, roads, bridges, hydro dams and similar items of tangible physical substance that allow government to provide services to the public. These assets help government to deliver service over a period of time that extends beyond the current accounting period.

Tangible capital assets are recognized as an asset on the Summary Financial Statements statement of financial position. Most of these assets are amortized into income over a period of time that reflects the useful life of the asset, whereas period costs such as salaries and rent are recognized in full in the current accounting period.

The length of time chosen to amortize a tangible capital asset can have a significant impact on the deficit or surplus of government for any given accounting period. For example, amortizing an $800 million bridge over 80 years would result in an annual expense of $10 million, whereas if 40 years was used, the expense in the year would double to $20 million. When we audit the tangible capital assets in the government's accounts, and those recorded in the commercial Crown corporations such as BC Hydro, we pay particular attention to the reasonableness of the amortization periods being used and seek assurance that the amortization rates reflect the actual useful life of the asset.

In the coming year we will continue to review the amortization periods used for all significant tangible capital assets. We will also consider the affect that the reporting of certain assets by government business enterprises under International Financial Reporting Standards will have on the government's Summary Financial Statements.

ACCOUNTING STANDARDS THAT ARE IN THE CONSULTATION STAGE

The accounting standards set by PSAB are not static, as noted in the section above. However, whenever standards do change they go through a rigorous public consultation process. Anyone from the public can comment on PSAB's "exposure drafts" – documents that explain the planned changes in standards. It can often take several years from the time an accounting change is deemed necessary to the time it is implemented in a set of financial statements.

PSAB currently has a number of accounting exposure drafts on their website (see www.psab-ccsp.ca). Among them:

- Entity Level Financial Statements
- Financial Instruments
- Financial Reporting by Government Not-for-Profit Organizations
- First-time Adoption of Public Sector Accounting Standards by Government Organizations
- Foreign Currency Translation
- Government Transfers

Of these, the one that has been the most controversial is Government Transfers.

In May 2010, PSAB issued the latest in a number of exposure drafts on the topic of accounting for government transfers. The current accounting standard dates back to 1990. Since 2002, PSAB has issued several exposure drafts and re-exposure drafts aimed at reaching a consensus among users as to what the accounting rules for government transfers should be. At issue has been how a transferring government, or a recipient government, should account for funding provided or received, respectively.

For our purposes, the main issue is how British Columbia should account for transfers received from the federal government. The exposure draft proposes that transfers be accounted for as revenue in the period in which they are received, unless there are stipulations attached to the transfer, which create a liability. In that case, the transfer can be deferred. For example, if the transferor specified the purpose for which the funds were to be used, then any unused funds at the end of year would be deferred.

This is a very brief summary of a complex exposure draft. If it becomes a standard, we will work with the provincial government to modify its accounting policies if needed, and identify the appropriate accounting for the transfers received from the federal government.

COMPOSITION OF THE GOVERNMENT REPORTING ENTITY

The Summary Financial Statements as at March 31, 2010, are a consolidation of 147 government organizations (Exhibit 9), plus the Consolidated Revenue Fund which is composed of eight legislative offices, the legislative assembly, the Office of the Premier and 20 ministries.

Some of the 147 government organizations in Exhibit 9 are themselves the consolidation of several other subsidiary organizations. For this reason, the actual number of audits carried out is much greater than the number of organizations listed in Exhibit 9. All of these together make up the "government reporting entity" and set the scene for a very large and complicated accounting and audit process.

GOVERNMENT'S FINANCIAL REPORTING FRAMEWORK

Under the Budget Transparency and Accountability Act in place at March 31, 2010, the Province's financial statements must be publicly reported in accordance with Canadian generally accepted accounting principles (GAAP).

In the public sector, entities can report their financial results using either PSAB accounting standards or those issued in the CICA Accounting Handbook. Within the CICA Accounting Handbook, entities have a choice of reporting under the standards for publicly accountable enterprises or not-for-profit organizations. Therefore, organizations within government could report their individual financial statements using PSAB, publicly accountable enterprise or not-for-profit standards.

PSAB requires government entities to use selection criteria to determine which GAAP basis of reporting they will follow in recording their financial activity and preparing their financial statements (Exhibit 10).

Exhibit 9: Government entities, by type, in the government reporting entity, 2009/10

Entity type	Number of entities
Crown corporations	43
School districts	60
Universities	11
Colleges	16
Health authorities	6
Hospital societies	10
Other organizations	1
Total	147

Source: Derived from the reporting entity schedule in the 2009/10 Summary Financial Statements

THE ACCOUNTING CONSOLIDATION PROCESS

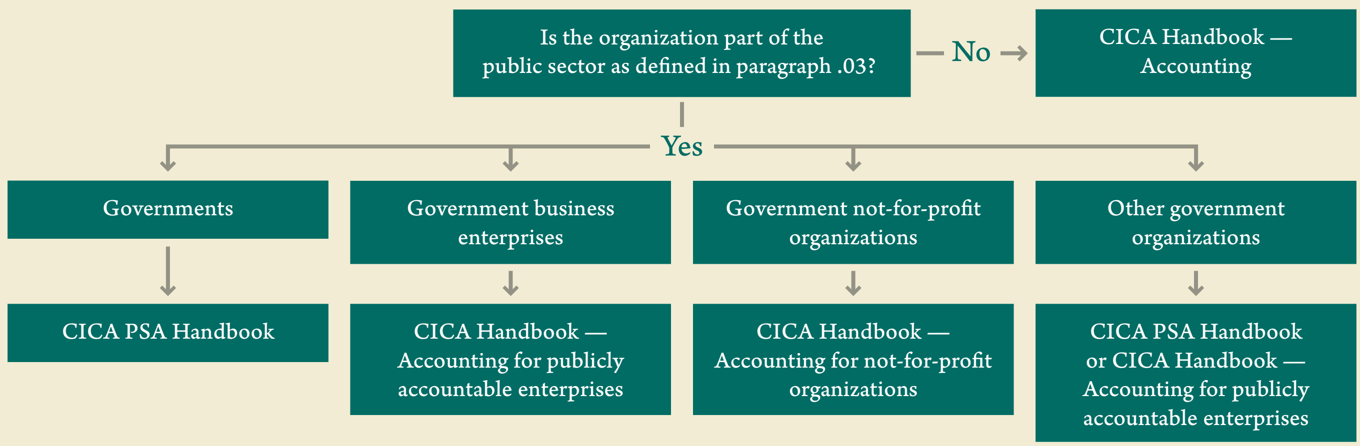
Each government organization is required to prepare annual financial statements, which are then audited by either the Auditor General or another audit firm (see Appendix C). The 147 audited financial statements are combined with the audited accounts of the Consolidated Revenue Fund to create the consolidated Summary Financial Statements that the Auditor General then audits and provides an audit opinion on.

Exhibit 11 shows how all of the 147 government organizations are grouped into sectors of similar business activity and are consolidated into the Summary Financial Statements.

These nine sectors are the basis for the segmented reporting prepared by government, and provide support for the Summary Financial Statements (refer to the Public Accounts, pages 84 to 91). What may not be readily apparent to the reader, however, is that not all government entities are consolidated in the same manner.

Most organizations (137 out of 147) are included in the Summary Financial Statements using a line-by-line consolidation method. Under

Exhibit 10: 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 of the standard 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.

this method, the accounting policies of each individual organization are made to conform to the accounting policies in the Summary Financial Statements. Transactions with all other organizations included in the Summary Financial Statements are eliminated. All financial statement lines are then added together to come to the total in the Summary Financial Statements.

Canadian GAAP allows certain government organizations to be included in the Summary Financial Statements using what is called the "modified equity" method of consolidation. This consolidation method is reserved for those government entities that meet certain criteria. In short, these "government business enterprises" must be self-supporting and must earn their revenues from outside of government.

Ten government business enterprises (GBEs) have been consolidated using the modified equity method, although in our view only nine entities should be consolidated using this method (see key issue #1 on page 5 regarding the full consolidation of the Transportation Investment Corporation, and see Appendix C, footnotes 3 and 4).

Under the modified equity consolidation method, the accounting policies of the GBEs are not changed to conform to the policies in the Summary Financial Statements. In addition, only the *profits* earned in transactions with other government organizations are eliminated upon consolidation, not the entire transaction. Finally, only the net income and the net equity of GBEs are recorded in the Summary Financial Statements, not each financial statement line item.

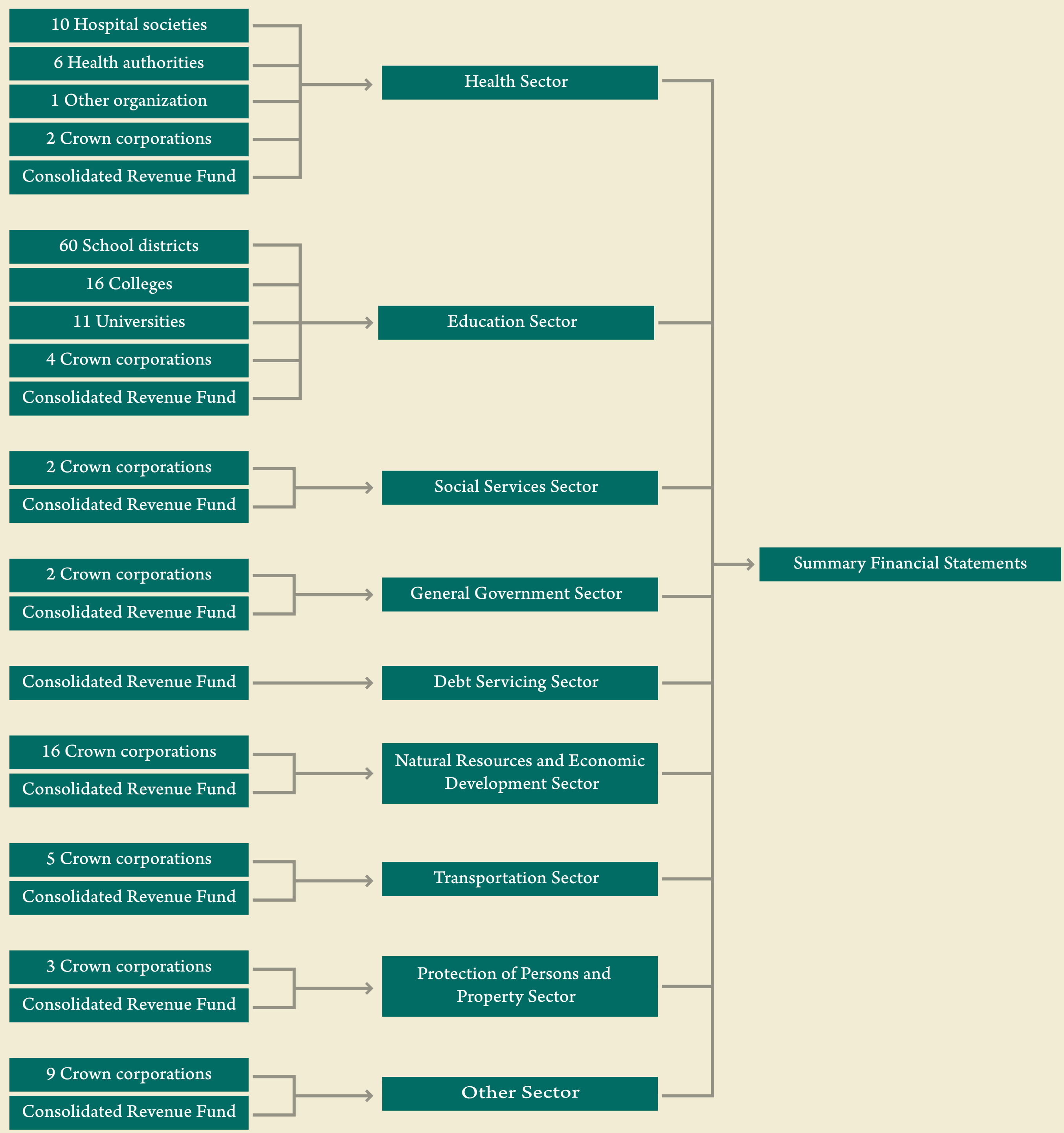
AUDITING THE SUMMARY FINANCIAL STATEMENTS

The Office of the Auditor General was established to carry out the audit of the provincial government's financial statements. Under the Auditor General Act, the Auditor General must report each year, in accordance with Canadian generally accepted auditing standards (GAAS), to the Legislative Assembly on the Summary Financial Statements.

A fundamental principle of GAAS is that auditors must have sufficient knowledge and understanding of the operations of the organizations they audit, including any organizations 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.

To meet GAAS, the Auditor General prepares a financial statement audit coverage plan (this annual plan is on our website at www.bcauditor.com/about/audit-coverage-plans). 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.

Exhibit 11: Consolidation of government organizations into the Summary Financial Statements, 2009/10



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

Source: Derived from the reporting entity schedule in the 2009/10 Summary Financial Statements.

Knowledge can be obtained by directly auditing individual organizations or by developing an audit coverage plan that relies on the work of other auditors who have been appointed to audit the individual organizations that will be consolidated.

Our audit coverage 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 organizations and across sectors. It also allows the Auditor General to provide, through varying levels of staff involvement with the audits carried out by other auditors, a government-wide perspective on significant accounting issues in government organizations and across sectors.

Although 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 knowledge of, and reliance on, their work.

MATERIALITY AND THE AUDITOR'S ROLE IN INFORMING USERS OF DEPARTURES FROM CANADIAN GAAP

Although the provincial government has stated it has a commitment to strong public reporting, this does not mean there will always be agreement between what government reports and what the auditors who assess that information think should be reported.

Financial statement accounting and reporting are not exact sciences. In many cases the accounting and reporting requirements are very clear, but professional judgement is still needed to assess both the dollar value of a transaction and how best to disclose it. Estimates are often used in accounting, and the amount of disclosure concerning a transaction or account balance can also require professional judgement to determine the item's significance to financial statement readers.

As auditors we are confident that our suggestions for accounting and reporting are well founded in the hierarchy of Canadian GAAP.

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").

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, when there is a failure to disclose essential information or information is presented in an inappropriate 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.

An auditor is required to determine materiality based on his or her perception of the needs of users. However, because it is difficult to predict with certainty who those users will be – or, indeed, even what the specific needs of the known users are – 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.

The auditor will ordinarily calculate a threshold as an initial step in assessing materiality (for example, half a percent of expenses). Typically, if the misstatements found by the audit are less than materiality, individually or in aggregate, no adjustment would be needed. Alternatively, if the misstatements are significant, an auditor may qualify the audit opinion for specific errors until the remaining misstatements are no longer material.

However, the auditor cannot rely solely on a quantitative assessment without exercising professional judgement in considering the qualitative factors that might affect the determination of materiality for a particular audit. Misstatements of relatively small amounts may have a material effect on the financial picture presented in the financial statements. For example, small misstatements would have a bigger impact than their monetary size if they:

- changed a deficit into a surplus (or vice versa);
- altered a trend, such that something that was increasing over the years now shows a decrease; or
- changed a key ratio.

Last year, for instance, the provincial government's revised forecast for the fiscal year projected total expenses of $38,405 million. At that level, we would usually consider that overall misstatements of less than $190 million would not be adjusted. However, the government also projected a $50 million surplus for the same year. Clearly, a misstatement that would increase expenses by $60 million and turn the surplus into a deficit is material in this context. The same would be true if the total of all misstatements taken together would increase expenses by $60 million.

This year, the government projected a deficit of $2.8 billion, so there was little concern that a projected deficit would turn into a surplus. However we still need to be alert for issues that could alter trends or change key ratios, such as the disclosure of debt as taxpayer-supported or self-supported.

Making the 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 that will have no impact on the reported balances 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.

In British Columbia, the government is required through the Budget Transparency and Accountability Act to prepare the Summary Financial Statements in accordance with generally accepted accounting principles (GAAP). As such, any departure from GAAP, whether material or not, puts the government in the position of being in non-compliance with legislation – another qualitative audit reporting consideration.

NEW CANADIAN AUDITING STANDARDS

New Canadian audit standards will soon affect all Canadian auditors. Auditing standards in Canada are the responsibility of the Canadian Institute of Chartered Accountants (CICA) Auditing and Assurance Standards Board. The new standards, referred to as Canadian Audit Standards, will essentially be identical to International Standards on Auditing, which are a set of high quality, globally accepted audit standards. The new standards took effect for reporting periods beginning December 15, 2009, which means that the new standards are effective for the audit of the Summary Financial Statements for the fiscal year ending March 31, 2011.

Because we are the auditor of the Summary Financial Statements, the new audit standard that will have the greatest impact on our office is the one that relates to audit of group (i.e. consolidated) financial statements.

The Office annually produces a financial statement audit coverage plan from which we determine the audits we will be involved in, and to what extent. This practice, which involves a risk assessment process, goes a long way toward helping us meet the requirements of the group audit standard because the standard requires us to be involved in the audit of all significant components of the Summary Financial Statements.

As an Office, we use a range of levels of involvement to gain knowledge of component organizations during the overall audit of the Summary Financial Statements. The range of involvement can vary – from directly auditing the component organization ourselves, hiring a firm to audit on our behalf while we still maintain control of how the audit is carried out, or overseeing the audit done by other auditors, to simply reviewing information requested from the component organizations and their auditors.

This standard defines a significant component of the Summary Financial Statements to be one that is of individual financial significance to the consolidated financial statements, or that, because of its specific nature or circumstances, is likely to include significant risks of material misstatement of the financial statements. Both of these assessments are based on professional judgement. The group audit standard also requires that the greater the relative significance of a component to the Summary Financial Statements, the greater our involvement in the audit should be.

Although we have already been using these principles in the development of our financial statement audit coverage plan, we expect that our current involvement in the work of component auditors will increase with the implementation of the new standards.

RESPONSE FROM GOVERNMENT

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 governments 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 information 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 information needs.

In his opinion on the 2009/10 Public Accounts, the Auditor General identified three areas of reservation which are outlined in this report.

Reservations of Opinion

1. Basis of Consolidation of the Transportation Investment Corporation

We believe that the Transportation Investment Corporation is best disclosed as a government business enterprise (GBE) under the modified equity basis of consolidation. The defining element of a GBE is that it is able to maintain its own operations from revenues raised outside the government reporting entity. Unlike taxpayer supported organizations, GBE's do not receive subsidies from their parent governments. An organization does not have to be profitable to be self-supporting.

The Transportation Investment Corporation will support its operations from toll revenue over the life of the program.

2. Provision for Deep Well Credits

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. This treatment would not represent the economic substance of the transaction because deductions are an integral part of the royalty which are only recognizable as revenue when the well produces, not when the well is drilled.

3. Oil and Natural Gas Producers' Royalty Credits

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 2009/10 Public Accounts.

Management Letters

In his report, the Auditor General has provided overall comments on issues identified in 153 separate management letters to government and other government organizations included in the Summary Financial Statements.

The organizations that receive management letters work with their auditors to address any reported findings. Although the specific management letter findings only relate to individual organizations, they may identify issues that are important to all government organizations. The issues are reviewed from a government reporting entity perspective as part of our ongoing effort to improve financial management and governance practices across all organizations that are included in the Summary Financial Statements.

Each year the Office of the Comptroller General works with Ministries and Crown agencies across the government reporting entity to resolve audit issues and identify systemic improvements to the financial management and reporting process identified during the year- end audit process.

Governance Survey

We are pleased to find that the overall governance survey response was positive and the majority of government's entities claim they use a range of good governance practices. Government has a robust governance framework including structures and associated authorities defined in legislation and policy. Government's Core Policy and Procedures Manual documents financial management policies. Information management policies and other general administrative policies for core government that are based on legislation, good practice and business needs are approved by Treasury Board. The "Crown Agency Accountability System" and "Shareholders' Expectations for British Columbia Crown Agencies" provides government and Crown agencies with the advice, information and support necessary to promote good governance, continuous improvement and accountability for Crown agency results. We will review the OAG best practice suggestions for potential addition to government's recommended Crown agency governance best practices.

Other Recommendations to Government

In addition to the reservations expressed in his opinion, the Auditor General also provides observations and recommendations in this report on areas of accounting or reporting that do not materially affect the financial statements.

Disclosure of Prior Year Adjustments

Recommendation: ***When prior year numbers have been restated, government should draw attention to the restated numbers with appropriate referencing and make full disclosure of the changes that have taken place, in accordance with Canadian generally accepted accounting principles.***

All material prior year adjustments are disclosed in Note 24 on page 70 of the 2009/10 Public Accounts. We do not specifically notate columns "as restated" in the financial statements because the government reporting entity is very large and there are always adjustments to prior year amounts. Instead, we provide disclosure of changes to comparative figures in Note 33 on page 77 of the 2009/10 Public Accounts.

Ministry Financial Statements

Recommendation: ***Government require individual ministries to prepare separate financial statements, and also prepare consolidated financial statements showing the results of the sectors they are responsible for.***

We do not agree that separate ministry financial statements 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. Ministries are divisional elements of government and their constitution, as well as their responsibilities change frequently as the priorities of government change. They are established as discretionary administrative units without the authority or responsibility for the full scope of financial operations that are represented by financial statements. For example, ministries do not have separable responsibility for key financial elements, like debt or revenue, which would be attributable to an autonomous entity like a Crown agency. Comparability of any financial statements of these divisions between years could not be maintained on a consistent basis.

Separate ministry financial statements are also inconsistent with the Summary focus of public sector accounting standards which requires that financial statements of governments be prepared on a consolidated basis, including all transactions of the government reporting entity including ministries and Crown agencies. From a financial management perspective, separate ministry financial statements could lead to decision-making that is focussed on the strategic needs of individual ministries rather than the broader needs of government.

Accounting for First Nations Settlement Costs

Recommendation:* *Government again review its accounting policy with respect to the settlement of First Nations' transactions to ensure the policy is in accordance with Canadian GAAP.

We have developed and implemented a provincial policy for the recognition and treatment of settlement agreements with First Nations and discussed the issue with the Auditor General. 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. In developing accounting policy for the recognition of modern treaty settlements, the Province has looked to the body of guidance that is generally accepted in accounting principles to determine how best to represent these transactions on a basis consistent with other agreements.

We believe that the cost of settlement agreements with First Nations should be recognized in the financial period that the Final Agreement is ratified by all parties. To recognize the transaction before it occurs, based on the expectation that it will occur, would not be consistent with accounting guidance.

Accounting for Inherited Crown Land

Recommendation:* *When inherited Crown Land is valued, the change in value be recorded in accordance with Canadian GAAP as a credit to accumulated surplus/(deficit) and not to revenue.

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. .57 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, which is consistent with the long standing policies of the province.

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.

Classification of Debt

Recommendation:* *Debt of the warehouse borrowing program and of the Transportation Investment Corporation be included with taxpayer-supported debt and not self-supported debt.

Warehouse Debt is presented and disclosed in the Public Accounts on a basis consistent with the Province's stated accounting policy, and is clearly described in Note 1 to the financial statements. Accounting standards require the Province to disclose the nature of debt, and the Province has adopted and maintains the longstanding policy of describing the nature of its debt primarily as taxpayer-supported or self-supported. Once defined, accounting policies must be consistently applied to ensure financial statement users are able to compare the information from one year to the next.

The government has disclosed Warehouse Debt as self-supported debt in Public Accounts since the program was started in the early 1990's. There has been no change to the program and as a result, there is no compelling reason to change the classification of the debt. The value of Warehouse Debt principal is guaranteed by investment in money market instruments of the Government of Canada and Canadian, high investment grade financial institutions. It has always been recognized that the investment returns on the pre-funded debt proceeds will rarely fully fund the interest payable on the debt. The Warehouse Debt Program fully passes on the net carrying cost to the client organization to whom the debt is allocated and therefore, the Warehouse Debt Program never incurs a loss.

Warehouse Program debt is consistent with the definition of self-supported debt because, as borrowing in advance of requirements, it is not funded by revenues received from taxpayers; it is funded by investment returns and the client organization to which the debt is allocated.

At the time of pre-borrowing for the Warehouse, it is not known whether a taxpayer-supported or self-supported client organization will draw debt from the program. It is therefore appropriate to make the final classification of the debt coincide with the allocation of the debt to the client organization.

Disclosure of Contractual Obligations

Recommendation:* *Government include additional information about the nature of contractual obligations in the Summary Financial Statements.

We currently fulfill the requirements of GAAP in disclosing contractual obligations in our financial statements and have provided additional detailed disclosure for the 2009/10 fiscal year as supplemental information to the Public Accounts.

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. While more detailed information may be valuable to interested parties, the narrow context of financial statement disclosure may not provide the best vehicle for reporting detailed information.

Additional detailed information on Contractual Obligations is available on the Government web site at www.fin.gov.bc.ca/pubs.htm.

Recommendation:* *Government use a lower cut-off for collecting and assessing the disclosure of contractual obligations in the Summary Financial Statements.

We do not believe it is practical to collect data on every long term contract that each of the organizations in the government reporting entity enters into. We have established a materiality level to ensure that each organization with a single contract 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 appropriately disclosed.

Pension Plan Disclosures

Recommendation:* *Government improve its disclosure of pension plans as required by Canadian generally-accepted accounting principles.

We believe that the three pages of disclosure of pension plans in the Summary Financial Statements meets the information needs of financial statement users and is consistent with the guidance provided by GAAP.

> *PS3250.089 The level of detail disclosed by governments would reflect the highly aggregated nature of summary financial statements. In deciding the level of detail to disclose, governments would consider the usefulness of the information to the reader in assessing the nature of, and the costs associated with, a government's retirement benefit plans. The level of disclosure would also consider the sensitivity of the information in relation to government's financial position.*

We also provide, in the financial statement note, a link to the detailed financial information for the independent public sector pension plans under joint trusteeship for any reader that requires additional information at www.pensionsbc.ca.

We believe the 2009/10 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 of British Columbia

CURRENT STATUS OF THE AUDITOR GENERAL'S RECOMMENDATIONS ON PRIOR YEAR PUBLIC ACCOUNTS

In our reports on the 2006/07, 2007/2008 and 2008/09 Public Accounts, we made a total of 46 recommendations. Of these, 7 were recommendations made in more than one year, 12 have been completed or substantially completed, 5 have been partially completed, 6 we have decided not to pursue at this time in our public report (some are reported to government in our annual management letter to the Comptroller General), and the 16 which are still outstanding (as well as one that was partially completed during the year) are listed below. As noted, some of these outstanding recommendations are made again in this year's report.

Report	*Auditor General Recommendations Not Yet Completed*	*Comment*
Government's financial statement discussion and analysis		
2006/07 #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 resolved. Government has capped its trend analysis at 5 years. Government does not cross-reference between the Financial and Economic Review and its financial statement discussion and analysis in the Public Accounts.
2006/07 #2	We continue to recommend that government continue to expand its financial statement discussion and analysis (FSD&A) to better cover material financial risks and uncertainties and the challenges involved in their ongoing management.	Not resolved. No changes noted in the 2009/10 financial statement discussion and analysis.
2006/07 #3	We continue to 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 resolved. Government continues to use total revenue in its calculation of this vulnerability measure.
Disclosure of contractual obligations		
2006/07 #4, 2007/08 #10 and 2008/09 # 5	We recommend that government include additional information about the nature of contractual obligations in the Summary Financial Statements	Not resolved. See discussion in this year's report.
2007/08 #11 and 2008/09 # 6	We recommend that government use a lower cut-off for reporting contractual obligations in the Summary Financial Statements.	Not resolved. See discussion in this year's report.

Report	Auditor General Recommendations Not Yet Completed	Comment
Disclosure of tangible capital assets under lease		
2006/07 #9 and 2007/08 #1	We continue to recommend that capital lease related liabilities be disclosed separately to meet Canadian GAAP standards on leased tangible capital assets.	Mostly resolved. The disclosure has been improved, but there is still room for improvement by disclosing particulars of significant leases. The PHH vehicle lease is not the most significant lease.
Disclosure of material errors		
2006/07 #11	We continue to 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 resolved. Government said it does not follow this practice. In our view it should be done for material prior year errors. See discussion in this year's report.
Complete disclosure of prior year adjustments		
2008/09 #4	We recommend that when prior year numbers have been restated, government draw attention to the restated numbers with appropriate referencing and make full disclosure of the changes that have taken place.	Not resolved. See discussion in this year's report.
Oil and natural gas producers' royalty credits		
2007/08 #3	We continue to recommend that government record royalty revenues on a gross basis as required by Canadian public sector accounting standards.	Not resolved. See discussion of qualifications in the Auditor General's opinion.
Provision for deep-well credits		
2007/08 #4	We continue to 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.	Not resolved. See discussion of qualifications in the Auditor General's opinion.
Accounting for, and recognition of, inherited Crown land revaluations		
2007/08 #7 and 2008/09 # 2	We continue to recommend that when inherited Crown land is valued, the change in value be credited directly to accumulated surplus/(deficit) and not to revenue.	Not resolved. See discussion in this year's report.

APPENDIX B

Report	Auditor General Recommendations Not Yet Completed	Comment
Accounting for First Nations settlement costs		
2008/09 #1	We recommend that the government again review its accounting policy with respect to the settlement of First Nations transactions to ensure the policy is in accordance with GAAP.	Not resolved. See discussion in this year's report.
Warehouse Debt accounting and disclosure		
2008/09 #3	We recommend that the debt of the warehouse borrowing program be included with taxpayer supported debt and not self-supported debt.	Not resolved. See discussion in this year's report under "Classification of debt."
Using the Direct Method for the Statement of Cash Flow		
2008/09 #7	We recommend that government present its statement of cash flow using the direct method	Not resolved. In 2008/09 the government proposed to use the direct method but was unwilling to gather the data necessary to prepare the statement without using significant estimates.
Authority to borrow		
2008/09 #8	We recommend that ministry staff keep an ongoing record of the amounts they are authorized to borrow. Government should consider providing a mechanism for legislative debate over the amount it intends to borrow, and implementing a mechanism to rescind previous, unused, authorities to borrow.	No change in 2009/10. While all recent debt issued had been authorized, there is no record of all outstanding, unused, authorizations to borrow.
Comparing budget information to the Summary Financial Statements		
2008/09 #9	We recommend that government improve its Budget and Estimates documents to include full line-by-line budget information for each of the sectors reported in the Summary Financial Statements, and to include the budget-to-actual information in the Summary Financial Statements. We also recommend that government provide budget information in the financial statements of organizations that make up the Summary Financial Statements.	No changes in 2009/10. Government has said it will continue to improve the alignment between the Budget and the Summary Financial Statements as they address the recommendations of the Budget Process Review Panel.
Ministry Financial Statements		
2008/09 #10	We recommend that government require individual ministries to prepare consolidated financial statements that include the financial results of organizations they are responsible for.	Not resolved. See discussion in this year's report.

MINISTRIES AND GOVERNMENT ORGANIZATIONS INCLUDED IN THE 2009/10 SUMMARY FINANCIAL STATEMENTS, AND THEIR AUDITORS

	Audited by	
Sector and Organization	Auditor General	Private Sector Auditors[1]
Consolidated Revenue Fund		
8 Legislative Offices, the Legislative Assembly, Office of the Premier	✓	
Ministry of Aboriginal Relations and Reconciliation	✓	
Ministry of Advanced Education	✓	
Ministry of Agriculture and Land	✓	
Ministry of Attorney General	✓	
Ministry of Children and Family Development	✓	
Ministry of Citizens' Services	✓	
Ministry of Community Development	✓	
Ministry of Education	✓	
Ministry of Energy, Mines and Petroleum Resources	✓	
Ministry of Environment	✓	
Ministry of Finance	✓	
Ministry of Forests and Range	✓	
Ministry of Health Services	✓	
Ministry of Healthy Living and Sport	✓	
Ministry of Housing and Social Development	✓	
Ministry of Labour	✓	
Ministry of Public Safety and Solicitor General	✓	
Ministry of Small Business, Technology and Economic Development	✓	
Ministry of Tourism, Culture and the Arts	✓	
Ministry of Transportation and Infrastructure	✓	

Sector and Organization	Audited by: Auditor General	Audited by: Private Sector Auditors[1]
Health Sector		
BC Academic Health Council		✓
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		✓
Shared Services Organization Administration Society	✓	
St. Joseph's General Hospital		✓
St. Michael's Centre		✓
Vancouver Coastal Health Authority		✓
Vancouver Island Health Authority	✓	
Wrinch Memorial Hospital		✓

Sector and Organization	Audited by: Auditor General	Audited by: Private Sector Auditors[1]
Education Sector		
British Columbia Institute of Technology		✓
Camosun College		✓
Capilano University		✓
College of New Caledonia		✓
College of the Rockies		✓
Douglas College	✓	
Emily Carr University of Art & Design		✓
Industry Training Authority	✓	
Institute of Indigenous Government		✓
Justice Institute of British Columbia		✓
Knowledge Network Corporation		✓
Kwantlen Polytechnic University		✓
Langara College	✓	
Leading Edge Endowment Fund		✓
Nicola Valley Institute of Technology		✓
North Island College		✓
Northern Lights College		✓
Northwest Community College		✓
Okanagan College		✓
Okanagan University College		✓
Private Career Training Institutions Agency		✓
Royal Roads University		✓

Sector and Organization	Audited by: Auditor General	Audited by: Private Sector Auditors[1]
Education Sector — Continued		
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)		✓
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)		✓

Sector and Organization	Audited by: Auditor General	Audited by: Private Sector Auditors[1]
Education Sector — Continued		
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)		✓

Sector and Organization	Audited by: Auditor General	Audited by: Private Sector Auditors[1]
Education Sector — Continued		
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)		✓
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 of the Fraser Valley		✓
University of Northern British Columbia		✓
University of Victoria		✓
Vancouver Community College		✓
Vancouver Island University		✓

Sector and Organization		Audited by: Auditor General	Audited by: Private Sector Auditors[1]
Natural Resources and Economic Development Sector			
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		✓	
Pacific Carbon Trust		✓	
Partnerships British Columbia Inc			✓
Tourism British Columbia		✓	
Transportation Sector			
BC Transportation Financing Authority		✓	
British Columbia Railway Company	3		✓
British Columbia Transit			✓
Rapid Transit Project 2000 Ltd			✓
Transportation Investment Corporation	3,4	✓	
Social Services Sector			
Community Living British Columbia		✓	
Legal Services Society			✓

Sector and Organization		Audited by: Auditor General	Audited by: Private Sector Auditors[1]
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 Sector			
British Columbia Securities Commission		✓	
Insurance Corporation of British Columbia	3		✓
Organized Crime Agency of British Columbia Society			✓
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 organizations 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 organizations are accounted for by the government as 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 The Transportation Investment Corporation does not meet the criteria to be a government business enterprise and should be consolidated on a line-by-line basis.

5 This entity is not audited.

GLOSSARY

Accounting Standards Board (ASB): a board that is part of the Canadian Institute of Chartered Accountants (CICA) and has the authority to develop and establish standards and guidance governing financial accounting and reporting in Canada.

Auditing and Assurance Standards Board (AASB): a board that is part of the Canadian Institute of Chartered Accountants (CICA) and has the authority to develop and establish standards and guidance governing auditing, assurance and related services in Canada.

Canadian Auditing Standards (CAS): generally accepted auditing standards for audits of financial statements. The CAS result from the adoption of International Standards on Auditing (ISA), developed and issued by the International Auditing and Assurance Standards Board (IAASB). The CAS will take effect for audits of financial statements for periods beginning on or after December 15, 2009. These standards are to be followed by every audit practitioner who issues an audit opinion on a set of financial statements.

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 organizations and government. The CICA issues guidance on control and governance, publishes professional literature, develops continuing education programs and represents the Chartered Accountant profession nationally and internationally.

CICA Handbook – Accounting: a collection of accounting standards and guidance for profit-oriented enterprises and not-for-profit organizations, issued by the Accounting Standards Board of the Canadian Institute of Chartered Accountants (CICA).

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 Standards (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 Canadian Institute of Chartered Accountants (CICA) and Public Sector Accounting Board (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 Canadian Institute of Chartered Accountants (CICA) to be followed by every audit practitioner who issues an audit opinion on a set of financial statements.

Government business enterprise: an organization that sells goods and services to individuals and organizations outside 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.

Government business-type organization: a government organization 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 another organization 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 organization normally without transferable ownership interest organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. Members, contributors and other resource providers of a not-for-profit organization do not, in such capacity, receive any financial return directly from the organization.

Government organizations: organizations 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 in which 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 polices on an ongoing basis; and share, on an equitable basis, the significant risks and benefits associated with the operations.

Government reporting entity: the collection of organizations that are controlled by government.

International Financial Reporting Standards (IFRS): accounting principles as laid down by the International Accounting Standards Board, to be followed in the preparation and presentation of financial statements. Canada will implement IFRS commencing January 1, 2011.

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. However, 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 Canadian Institute of Chartered Accountants (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 Public Sector Accounting Board (PSAB).

Reservation of (audit) opinion: an auditor expresses a reservation in an audit opinion if the financial statements are materially affected by a departure from GAAP; or when an 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 and which:

(i) are held for use in the production or 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.