Report 6: September 2011

OBSERVATIONS ON FINANCIAL REPORTING: SUMMARY FINANCIAL STATEMENTS 2010/11

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of British Columbia

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

As mandated under Section 11 of the *Auditor General Act*, I have the honour to transmit to the Speaker of the Legislative Assembly of British Columbia my 2011/2012 Report 6: *Observations on Financial Reporting: Summary Financial Statements 2010/11.*

This report represents my observations from my annual audit of the province's Summary Financial Statements – the largest financial statement audit carried out in British Columbia. This report explains why I had to qualify my opinion on government's Summary Financial Statements, as well as why I removed two of the three qualifications that were in my prior year's audit report, despite the fact that government has not corrected these errors.

As well, this report also addresses:

- comments regarding the future direction of accounting and assurance standards, including government's use of rate-regulated accounting;
- a summary of control weaknesses noted from audits across the government reporting entity;
- other issues regarding the government's application of Canadian generally accepted accounting principles; and
- areas where government could improve the quality of financial reporting in its Public Accounts.

As with all of my reports, this report, as well as a slideshow summary, will be available on my Office's website at www.bcauditor.com and will be referred to the Select Standing Committee on Public Accounts for discussion as required by legislation.

John Doyle, MAcc, CA
Auditor General

Victoria, British Columbia
September 2011

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John Doyle, MAcc, CA
Auditor General

The audit of government's 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, as well as that of many private sector auditors.

My audit opinion for the 2010/11 fiscal year contains one audit reservation, indicating that the financial statements are not in compliance with Canadian generally accepted accounting principles (GAAP). This is one of the same three audit reservations that featured in my 2009/10 opinion. The other two reservations were removed from my opinion this year: not because government had changed its accounting for them, but only because of their reduced financial magnitude this fiscal year.

Independent Canadian standard-setting bodies continue to change the accounting standards landscape. Almost every organization across the government reporting entity will be following a new accounting standard within the next two fiscal years. This will involve a significant amount of effort by government, as well as by staff in my Office and other assurance providers that carry out public sector audits. To assist in this transition, my Office recently published model public sector financial statements and other guidance, which can be found on our website at www.bcauditor.com/model-financial-statements.

In *Observations on Financial Reporting: Summary Financial Statements 2009/10* I noted a concern that, in response to the potential impact of changing accounting standards, government had amended the *Budget Transparency and Accountability Act* (BTAA). The amendments set the stage for the B.C. government to depart from reporting its financial statements under Canadian GAAP. Recently government took the next step by amending the BTAA to change its future definition of GAAP for BC Hydro's rate regulated balances, which are very significant. I remain very concerned that government is choosing to override the independent standard-setting process. This is discussed in more detail in this report.

A related concern is that, despite assurances, government is not actively engaging in consultation with my Office regarding these significant future events. It is normal good practice to keep an open dialogue and share analysis with the external auditor on significant potential accounting changes, since they may well affect the audit opinion on government's financial statements.

This report also includes: 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 other issues that were encountered during the audit that will be of interest to legislators and the public.

Government ended the March 31, 2011 fiscal year with a Summary Financial Statement annual deficit of $300 million. This is good news in comparison to the $1.7 billion deficit originally predicted in March 2010, and compared to the $1.3 billion deficit predicted as recently as February 2011.

Looking ahead to future reports, I plan to look at other topics that have a financial management focus, including:

- Budgeting and forecasting by government.
- Funding models in the health and education sectors.
- The quality of government's reporting on its finances outside of the Summary Financial Statements.
- A continued emphasis on working capital management, and other aspects of financial management.

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 2010/11 Summary Financial Statements.

John Doyle, MAcc, CA
September 2011

AUDIT TEAM

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Assistant Auditor General

Peter Bourne
Executive Director

Pat Hundal
Auditor

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Senior Audit Associate

SUMMARY OF RECOMMENDATIONS

WE RECOMMEND THAT:

1 Government revise its definitions of self-supported and taxpayer-supported debt to better describe the nature of the debt.

2 Government include the debt of the warehouse borrowing program with taxpayer-supported debt and not with self-supported debt.

3 Government classify gaming grants in the statement of operations according to the purpose of the grant provided.

4 Government record an estimate of tax appeals that have not yet been assessed as an accrued liability in the Summary Financial Statements. Because the accrual will be based on an estimate, government should also disclose the amount of uncertainty around the estimate in the Measurement Uncertainty note (note 2) to the Summary Financial Statements.

5 When government's planned Estimates are not prepared on a basis consistent with that used to report the actual results, the planned results be restated. As well, a reconciliation should be provided that shows the amendments made from the original Estimates to the amounts reported in the Summary Financial Statements.

6 Government provide more complete disclosure of the anticipated payments to be made after five years so that stakeholders can fully appreciate the duration and timing of these obligations.

7 Government expand its existing supplemental contractual obligation disclosures to ensure that stakeholders have access to information they might find significant. Disclosures should include:

(a) significant terms and conditions of the contracts that could impact expected future cash inflows or outflows and service delivery continuance, key renewal and termination options, and any other rights or obligations that could have a material impact on the contract or on users of that contracted service;

(b) more complete descriptions of the rules used to compile the supplementary contractual obligation disclosures, as well as any significant limitations these rules could impose on the use of the information; and

(c) comparative contractual obligation information to help readers understand trends in government's contractual obligations.

8 Government provide the supplemental contractual obligation disclosure information to the public in a format that is easy to use and that facilitates further stakeholder analysis and evaluation of results.

INTRODUCTION

On July 18, 2011, the provincial government released the audited Summary Financial Statements of the Province of British Columbia for the year ended March 31, 2011.

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, 17 ministries and 145 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 they provide an indication of the financial well-being of the Province.

The audited Summary Financial Statements are included in government's Public Accounts (available at www.fin.gov.bc.ca/ocg/pa/10_11/Pa10_11.htm). The Public Accounts also include unaudited information, such as government's financial statement discussion and analysis report, and information about the Consolidated Revenue Fund and the provincial debt.

It is interesting to note that when the government produced its annual Estimates (budget) in March 2010, it anticipated a $1.7 billion deficit for the year ending March 31, 2011. Instead, as the Summary Financial Statements show, the Province had a deficit of only $300 million – a significant improvement from the planned deficit. Even when government presented its 3rd quarter update on February 15, 2011 a year-end deficit of $1.3 billion was still projected. From this point it appears that government improved its financial position by $1 billion in the final three months of the fiscal year.

We would have expected the government to highlight the reasons for such an improvement in its financial statement discussion and analysis report (FSD&A). The purpose of the FSD&A should be to "tell the story" of government's finances for the year – that is, what factors caused the accounting results to be what they are, and why the result differed from what was planned. However, aside from a table on page 20 of the Public Accounts showing some revenue and expense variances from the budget, there is little information to enable the public to determine why the results were so different than planned.

In past reports we have commented on government's lack of disclosure in its financial statement discussion and analysis report. We again encourage the government to improve the quality of this important report on its financial performance.

KEY ISSUES

We identified several issues behind the financial statement figures as being important to bring to the public's attention.

The five most significant accounting and audit issues are the following:

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) as provided by the Canadian Public Sector Accounting Board (PSAB). There is one reservation this year, compared with three in the previous year. The reservation refers to 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 *Audit opinion reservation, 2010/11* on page 10.
2. Two of last year's audit opinion reservations have been removed this year. However, the reason for their removal is not that government has corrected the errors, but only that the significance of the errors in relation to the Summary Financial Statements as a whole has decreased. The first issue relates to government not recording liabilities for deep-well credits owed to oil and gas producers. The second issue is that oil and natural gas producers' royalty credits are being netted from revenue rather than being reported as expenses. If government does not correct the accounting for these issues, the result may be audit opinion reservations in future years. For more details, see *Audit opinion reservations removed* on page 12.
3. Accounting standards are in the process of changing. This could have a significant impact on how government, and government organizations, account for transactions. See *Accounting standards are changing* on page 12.
4. Accounting by rate-regulated entities such as the BC Hydro and Power Authority continues to be a significant issue. If government had not been permitted by current accounting standards to defer

certain expenses, government's annual deficit would have been approximately $450 million higher this year. See *Rate-regulated accounting* on page 15.

5. Since April 1, 2010 an amendment to the *Budget Transparency and Accountability Act* has provided government with the flexibility to change how it defines generally accepted accounting principles (GAAP). Although government has not yet made use of the legislation, it has the potential to adversely affect the reliability of financial reporting. See *Government's response to changing accounting standards* on page 16.

MANAGEMENT LETTERS: A WEALTH OF INFORMATION

We have once again compiled the recommendations of all the auditors' management letters across the government reporting entity. Management letters are a way for auditors to communicate to management and governing boards the significant issues found during audits. The number and significance of issues brought forward during 2010/11 show there is room for improvement in the controls over government operations. See *Management Letters: A Wealth of Information* on page 18.

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 government's accountability to legislators and the public. In our view, continuing to discuss prior year issues like this is necessary because such matters are important and should be resolved.

Topics that include recommendations:

- *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 gaming grants* – Gaming grants should be disclosed on the statement of operations in accordance with the purpose of the grant. See page 25.
- *Accounting for tax appeals* – Government should estimate and record a liability for unassessed tax appeals in the Summary Financial Statements. See page 26.
- *Disclosure of changes in budgets* – Government is required to present budget information in the Summary Financial Statements. When government's budgets change, this should be disclosed. See page 26.
- *Transparency and utility of contractual obligation disclosures* – At March 31, 2011, government's contractual commitments exceeded $80 billion. In our view, government should be providing better disclosure of these obligations. See page 27.

Also important to note is that there are many recommendations from prior years that government has still not resolved. We track the outstanding recommendations we have made to government in previous editions of this report. The status of recommendations is included in Appendix B. See *Current Status of the Auditor General's Recommendations on Prior Year Public Accounts* on page 42.

OTHER ISSUES OF INTEREST

In this report we discuss other issues of interest as well, without making specific recommendations to government. The topics include:

- *The government reporting entity: what's in and what's out? See page 29.*
- *The role of management and the auditor in protecting government from fraud. See page 30.*
- *Working capital management. See page 31.*
- *Carbon neutrality. See page 31.*
- *Early adoption of Public Sector Accounting Board standards: impact on the BC Transportation Financing Authority. See page 32.*
- *Accounting standard changes not yet implemented. See page 32.*

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. The topics include:

- *Composition of the government reporting entity. See page 34.*
- *Government's financial reporting framework. See page 34.*
- *The accounting consolidation process. See page 35.*
- *Auditing the Summary Financial Statements. See page 35.*
- *Materiality and the auditor's role in informing users of departures from Canadian GAAP. See page 37.*
- *Unadjusted errors. See page 38.*

1. AUDIT OPINION RESERVATION, 2010/11

Unqualified audit opinions are important

Audit reports are an auditor's way of communicating with the financial statement user. The report is an auditor's opinion on whether the financial position of an entity is presented fairly in its financial statements. Audit reports can also bring to the readers' attention any concerns the auditors have with the financial statements.

Many people assume that the financial results of an entity are fairly presented, without reading the attached audit report. A standard audit report – that is, one without reservations – indicates that the statements can be held to a higher level of reliability than can statements without such a report.

A reservation is a concern that an auditor has regarding the fairness of how something is reported in a set of financial statements. When auditors issue a "qualified report," they are indicating concerns with the availability of sufficient and appropriate information about the entity's financial operations, or with the entity's compliance with accounting standards (GAAP).

An audit report with reservations can impact the operations of an entity by:

- lowering the entity's credit rating or its share price; or
- increasing the interest rates the entity's lenders charge, which in turn increases the entity's cost of raising money.[1]

Public corporations (entities traded on a securities exchange) are required to have unqualified audit reports annually.

In British Columbia, if a public corporation were given an audit opinion with a reservation, the British Columbia Securities Commission would normally place a "cease trade" order against the corporation. The public corporation then runs the risk of being delisted by the stock exchange on which it is traded.

No data are available nationwide on how many qualified audit reports are issued for public corporations in Canada, or how many cease trading orders have been issued in response to qualified audit reports. It is likely, however, that reservations on public corporations are extremely rare because of the severe consequences.

While no government in Canada is subject to public corporation requirements, a qualified audit report could impact the jurisdiction's credit rating or cost of debt. Thus, ideally, no reservations should have to be issued. According to the public sector accounting standards of the Canadian Institute of Chartered Accountants, "governments are held to a higher standard of accountability than a business or a not-for-profit organization."[2]

That may be so, but in British Columbia accountability for not complying with GAAP appears to have had little impact on government.

Because the Auditor General found that the Province had not materially (significantly) complied with GAAP, he qualified his report on the provincial Summary Financial Statements for the fiscal year ended March 31, 2011. The reasons for this reservation are explained in more detail below.

As well, qualified audit reports were issued to two of the approximately 150 organizations in the government reporting entity.

Failure to properly consolidate the Transportation Investment Corporation

The reservation on the 2010/11 Summary Financial Statements concerns how the Province is consolidating a specific entity: the Transportation Investment Corporation (TIC). This reservation has also been included as an audit opinion qualification each year since 2008/09.

At the end of every fiscal year, the Province combines all the financial information of all entities within its control and produces a consolidated set of financial statements called the Summary Financial Statements.

1 Other variables also impact these items. Note that, to date, a qualified audit report has not impacted the Province's credit rating or cost of debt.
2 Canadian Institute of Chartered Accountants, *Public Sector Accounting Handbook*, section 1100, Appendix A, point 9.

In the public sector, the consolidation method depends on what type of organization each entity is classified as. Public sector GAAP standards have specific criteria for classifying organizations. For the Summary Financial Statements, an entity can be part of:

- government (e.g. a ministry),
- a government business enterprise (GBE; e.g. BC Lottery Corporation),
- a government not-for-profit enterprise (e.g. Community Living BC) or
- an "other government organization" (e.g. Oil and Gas Commission).

Most types of organizations are consolidated on a line-by-line basis. The exception is GBEs, which are consolidated on a modified equity basis.

When a government organization is consolidated on a line-by-line basis, each item from the organization's financial statements is added into the Province's financial statements after transactions with other government organizations and ministries are removed and adjustments are made to bring the items under the same accounting standards.

When a GBE is consolidated on a modified equity basis, transactions are consolidated differently. For example, only the initial contribution of money to the organization from the government (adjusted for annual earnings or loss) is included in the Province's financial statements. In addition, the accounting standards followed by the organization are not adjusted to be the same as government's, nor are adjustments made for transactions with other government organizations and ministries, apart from those involving the sale of assets.

Although the Transportation Investment Corporation (TIC) is defined as a GBE by government and consolidated on a modified equity basis, in fact the entity does not meet all four of the GAAP criteria that are required for it to be a GBE. It should therefore be consolidated on a line-by-line basis.

The two criteria it does not meet are that the entity:

1. Does not, as its principal activity, sell goods and services to individuals and organizations outside of the government reporting entity, and
2. Does not, in the normal course of its operations, maintain its operations and meet its liabilities using revenues received from sources outside of the government reporting entity.[3]

Currently, the TIC is responsible for the Port Mann Highway Improvement project, which includes replacing the existing bridge and building facilities to collect tolls from users. The new bridge is under construction. Until it is built and the toll booths are operational, it will not be "selling" a service to anyone. The only revenue source the corporation has at present is the interest income being earned on the funds provided by government debt.

The financial model developed by the TIC forecasts that it will not be profitable until 2017/18. As well, many variables (for example, actual highway usage compared to planned) could impact the future revenue estimates in the financial model and therefore affect the date that the TIC actually becomes profitable.

For these reasons, the TIC does not meet the GAAP criteria of a GBE, and it should be consolidated on a line-by-line basis as required by the standards.

The financial impact that the TIC's consolidation has on the Summary Financial Statements for 2010/11 can be summarized as follows:

- Cash is understated by $23 million.
- Accounts receivable is overstated by $22 million.
- Equity in self-supported Crown corporations is overstated by $130 million.
- Loans for the purchase of assets, recoverable from agencies is overstated by $1,148 million.
- Tangible capital assets is understated by $1,611 million.
- Accounts payable and accrued liabilities is understated by $401 million.
- Other assets is overstated by $52 million.
- Deferred revenue is overstated by $119 million.
- Taxpayer-supported debt is understated by $1,133 million.
- Self-supported debt is overstated by $1,133 million.
- Investment income is overstated by $76 million.
- Interest expense is overstated by $76 million.
- Contractual obligations (as disclosed in the notes to the Summary Financial Statements) total $1,114 million and should be classified as being for taxpayer-supported Crown corporations instead of for self-supported Crown corporations.

3 The *CICA Public Sector Handbook* defines GBE characteristics in section 1300.28.

These significant differences resulting from the consolidation show why the Auditor General issued the audit opinion with a reservation.

2. AUDIT OPINION RESERVATIONS REMOVED

Removal of two of the prior year audit opinion reservations

Two of the three reservations that were in the Auditor General's prior year's audit opinion on the Summary Financial Statements have been removed. Although the removed items are still errors under Canadian generally accepted accounting principles (GAAP), when combined with other smaller errors not corrected by government the overall effect on the Summary Financial Statements no longer warranted mention in the opinion. This year government improved its correction of errors found by us, resulting in fewer overall unadjusted differences.

That said, these two errors may result in future qualifications if other errors not corrected by government increase, or if the amount of these two errors increases.

The previous reservations are summarized below. For a more complete discussion of the accounting issues behind the two prior year reservations, see our information bulletin "Unqualified audit opinions are important: A discussion on the 2009/10 qualified audit opinion on B.C.'s summary financial statements" at www.bcauditor.com/resources.

1. Failure to provide for deep-well credits

The Province's failure to set up a provision, or liability, for the deep-well credits given to oil and gas producers resulted in a reservation in the Auditor General's audit opinion on the Summary Financial Statements for the fiscal years 2007/08 through 2009/10.

Deep-well credits are used to reduce the amount of royalties that the oil and gas producers must pay to the Province when they extract oil or gas from a well drilled to a specified depth. This incentive program, authorized by order-in-council and established by regulation, was initiated to encourage further development of oil and gas resources.

From an accounting perspective, deep-well credits are an expense incurred by the government to promote the growth of the oil and gas resource industry, and should therefore be recorded as a liability of the Province.

The financial impact on the statements of not recording deep-well credits for fiscal 2010/11 is as follows:

- Expenses are understated by $205 million.
- Liabilities are understated by $339 million.
- Deficit for the year is understated by $134 million.

2. Inappropriate netting of oil and natural gas producer royalty credits

In addition to the deep-well credits noted above, the Province rewards credits to oil and natural gas producers for other programs, such as road construction and summer drilling. The Province records all of these credits as a reduction to royalty revenues in the Summary Financial Statements. Public sector GAAP requires that both revenues and expenses be recorded on a gross basis (the one exception is taxation).[4] That is, expenses and revenues are not allowed to be netted against one another. They must be recorded on separate lines in the financial statements.

The Province's inappropriate netting of these oil and natural gas producer royalty credits resulted in a reservation in the Auditor General's audit opinion on the Summary Financial Statements for the fiscal years 2007/08 through 2009/10.

The financial impact on the Summary Financial Statements of inappropriate netting for fiscal 2010/11 is as follows:

- Royalty revenues are understated by $469 million.
- Incentive credit expenses are understated by $419 million.
- Deficit for the year is overstated by $50 million.

3. ACCOUNTING STANDARDS ARE CHANGING

Government is a complex organization with significant flows of money and transactions for which it can be difficult to properly account. It is therefore essential that the accounting policies chosen to record and report those transactions reflect best practices for making the financial

4 *CICA Public Sector Handbook* section 1200.080-1200.081 notes that the only exception to recording revenue on a gross basis is tax revenues, against which tax expenditures are allowed to be netted.

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).

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 accountable enterprises. Together, these standards are referred to as Canadian GAAP.

In the rare 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.[5] However, when a Canadian jurisdiction looks to other sources of GAAP, it must choose policies that are consistent with this country's GAAP and with PSAB's conceptual framework for accounting standards.

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

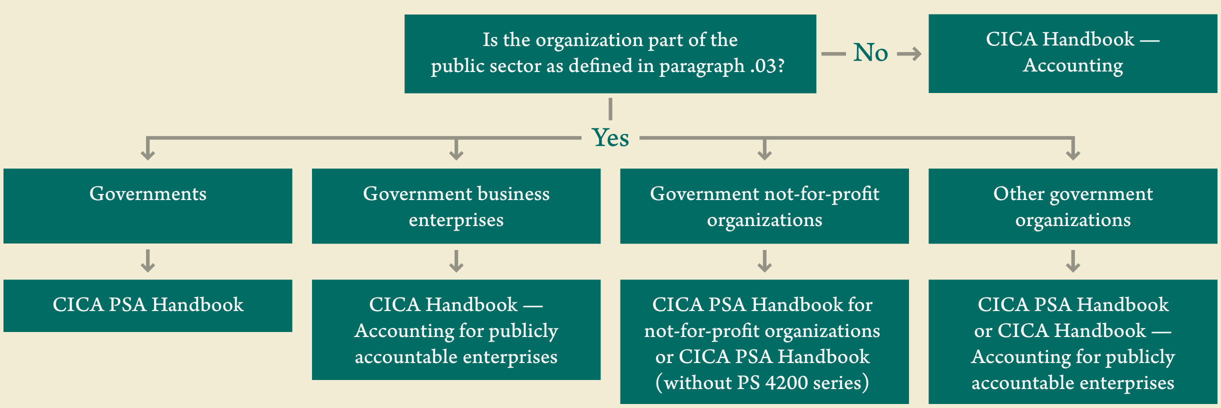
- provide an accounting of the full nature and extent of the financial affairs and resources that government controls, including those related to the activities of its agencies and enterprises;
- describe government's financial position in a way that is useful for evaluating government's ability to finance 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 2010/11 Summary Financial Statements. However, accounting standards in Canada will soon be changing.

In December 2009, and again in December 2010, 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 in fiscal 2011/12, and it also provides direction as to the source of GAAP to be used by those organizations where the PSAB handbook is not appropriate.

Exhibit 1 shows the accounting standards that will apply to public sector entities.

Exhibit 1: Canadian GAAP basis for preparing public sector financial statements



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.

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

Government organizations 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 organizations);* and
- other government organizations *(for example, British Columbia Assessment Authority and British Columbia 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 either follow the standards for not-for-profit organizations in the *Public Sector Accounting Handbook*, or to follow the *Public Sector Accounting Handbook* without the not-for-profit provisions; 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 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.

Many organizations in British Columbia's public sector will be adopting either the *Public Sector Accounting Handbook* without not-for-profit provisions or IFRS for the first time in the 2011/12 fiscal year as a result of these changes.

As discussed on page 16, schools, universities, colleges and health entities will adopt PSAB without not-for-profit provisions during the 2012/13 fiscal year.

As discussed under the topic of rate-regulated accounting on page 16, although most government business enterprises are directed to adopt IFRS beginning January 1, 2011, those enterprises that are defined as rate-regulated do not need to adopt IFRS until fiscal years beginning on or after January 1, 2012.

As well, as noted on page 32 the BC Transportation Financing Authority adopted PSAB standards early, during the fiscal 2010/11 year.

The changeover is a major challenge for some organizations. It has required, and will continue to require, a significant investment of time and resources by management. This is also true for our Office as transition results in a shift in how audit engagements are 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, 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 potential 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 significant 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.

We have developed a set of PSAB Model Financial Statements, available on our website at www.bcauditor.com/resources, which government entities will find useful when converting their financial statements to the format required by PSAB. Our website also includes a summary comparison of PSAB standards to the current CICA accounting standards (*Accounting Handbook Part V*). This resource will help determine the extent of difference between the two accounting standards. It will be updated in the fall of 2011.

4. RATE-REGULATED ACCOUNTING

Rate-regulated accounting was a key issue in our report last year, and it continues to be a significant issue that has a large dollar impact on financial reporting.

The purpose of rate regulation is to ensure that:

- ratepayers receive safe, reliable and non-discriminatory 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 approves 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.

In 2010/11, two Crown corporations were regulated by the BC Utilities Commission: British Columbia Hydro and Power Authority (BC Hydro); and the Insurance Corporation of British Columbia (ICBC). (The year prior, three Crown corporations had been regulated by the commission, but one – the British Columbia Transmission Corporation – was combined with BC Hydro.)

The Province includes BC Hydro and ICBC in the Summary Financial Statements using the modified equity method of consolidation. This means that any rate-regulated accounting policies used by these entities would not be converted to the accounting policies of general government.

The most significant impact of this on the Summary Financial Statements comes from the effects of rate regulation on BC Hydro (as disclosed in note 37 of the Summary Financial Statements). In 2010/11, that effect has been to increase the net earnings of BC Hydro and thus reduce the annual deficit recorded in the Summary Financial Statements by $447 million (compared with $695 million in 2009/10). BC Hydro also holds unamortized net regulatory assets of $2,160 million. These regulatory assets are, in effect, expenses that have been deferred to future years.

The BC Utilities Commission, although purported to be independent of BC Hydro and ICBC, is nonetheless a provincial agency. Government, through the Lieutenant-Governor-in-Council, appoints the commission's members and the government has sometimes given special direction to the utilities commission that affects the profitability of the regulated entities.

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

Nevertheless, BC Hydro and other commercial Crown corporations are government business enterprises. As such, they are required by the Public Sector Accounting Board to transition to International Financial Reporting Standards (IFRS) for fiscal years beginning January 1, 2011.

However, IFRS does not permit 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.

In October 2010 the Canadian Accounting Standards Board issued an amendment to the introduction to Part 1 of the *CICA Handbook – Accounting* that will permit rate-regulated entities to continue to use current Canadian accounting standards for one additional year. As a result, BC Hydro will be able to use rate-regulated accounting until March 31, 2012. This will allow time for BC Hydro to complete its preparations for adopting IFRS.

Last year, the provincial government amended the *Budget Transparency and Accountability Act*. Under the amended Act, the government has given itself 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 2012.

Government's response to rate-regulated accounting in 2011 is discussed in the next section.

5. GOVERNMENT'S RESPONSE TO CHANGING ACCOUNTING STANDARDS

In this section we discuss government's response to the changing accounting standards described on page 12, and to rate-regulated accounting as described on page 15.

Government accounting standards

The Office of the Comptroller General has consulted with organizations within the government reporting entity to discuss the accounting practices that each might be directed to follow. The potential standard choices are noted in Exhibit 1 on page 13.

Government determined that government business enterprises will convert to International Financial Reporting Standards (IFRS) for fiscal years beginning January 1, 2011. One exception to the conversion to IFRS in 2011 is BC Hydro – this is discussed below with respect to rate-regulated accounting.

Government directed that all taxpayer-supported organizations, except for schools, universities, colleges and health entities (the SUCH sector), adopt PSAB standards, without not-for-profit provisions, for fiscal years commencing after January 1, 2011. As a result, most government Crown corporations will convert to PSAB standards during the 2011/12 fiscal year.

Government directed that organizations in the SUCH sector adopt PSAB standards, also without not-for-profit standards, for fiscal years commencing after January 1, 2012.

Government made an exception for the BC Transportation Financing Authority, allowing the BCTFA to transition to PSAB standards one year early, during the 2010/11 fiscal year. Aspects of that transition are discussed on page 32.

There are still some accounting issues that must be clarified due to the transition to PSAB standards. One in particular is the accounting for contributions in universities, health authorities and other entities that accept donations. Under the not-for-profit accounting standards currently in use it is permissible to defer the recognition of some types of revenue until the related expenditures are made.

Under PSAB, without not-for-profit provisions, the revenue will be recognized when received or receivable. This is not an issue in itself; however, when combined with the government's current policy that organizations not incur an annual deficit, it will make it difficult for organizations to spend all the funds received each year. It could result in spending decisions that are made for the sole purpose of not incurring a deficit, rather than decisions that make sense for the organization, the contributors and the ultimate recipients of the donations.

In our view government should ensure that the mechanisms it uses to control government finances are congruent with the cyclical nature of revenues and expenses, and result in good business practices.

Rate-regulated accounting

Last year we noted that there could be significant changes in how government accounts for transactions as a result of the government's amendment of its *Budget Transparency and Accountability Act* (BTAA). The amendment, effective April 1, 2010, allows government to alter its interpretation of Canadian GAAP.

The BTAA now allows the government to adopt accounting standards of its own choosing rather than always having to follow the GAAP framework provided by PSAB. If the government does decide to amend any of its accounting standards in this way, it would 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. However, the BTAA also allows government to adopt only a part of the alternate accounting standard, which could defeat the purpose of limiting the choice of alternate accounting standards to those that are generally accepted elsewhere.

Last year government told us that the purpose of the BTAA amendment to its definition of GAAP was to ensure that government was able to address potential inconsistencies or conflicts during the transition of accounting standards to IFRS.

One such conflict has been the uncertainty over whether or not IFRS would allow the use of rate-regulated accounting by companies such as BC Hydro. Current Canadian accounting standards allow BC Hydro to use rate-regulated accounting until March 31, 2012. After that date, BC Hydro would convert to IFRS, which does not currently allow rate-regulated accounting.

As noted on page 15, the inability of government to use rate-regulated accounting would have increased the deficit by $447 million in 2010/11 (compared to an increase in the deficit of $695 million in 2009/10).

Importantly, in July 2011 government passed an amendment to the BTAA that will change its definition of GAAP. The legislative amendment requires BC Hydro, beginning April 1, 2012 and for subsequent fiscal years, to move away from Canadian GAAP (IFRS) and instead use the United States Financial Accounting Standards Board rate-regulated accounting standard.

Government has directed BC Hydro to use U.S. accounting standard FAS980 Regulated Operations, although with an important exception. Under FAS980, in order to use rate-regulated accounting the regulator must be independent of those being regulated. In British Columbia, the BC Utilities Commission is not independent of BC Hydro. Therefore, the government is requiring that BC Hydro use FAS980 except that the part of the standard that requires the regulator to be independent is not being adopted.

As a result of this legislation, government has taken it upon itself to define GAAP, rather than following the standards set by the Canadian Accounting Standards Board. It concerns us that government is willing to override the due process that is involved in the setting of Canadian accounting standards, and instead legislate an accounting result that will have a significant effect on the financial statements of BC Hydro and the Province's Summary Financial Statements.

Ultimately, if the accounting standards and the government's definition of GAAP are implemented in 2012 as they have been presented today, then the Auditor General will need to consider the impact of these amendments on the audit opinions of BC Hydro and the Summary Financial Statements.

Last year in this report we noted that it is common practice for an organization to consult its auditors when the organization is contemplating changing its accounting policies. We requested that the government consult with the Office of the Auditor General before implementing any significant accounting changes. No consultations occurred when the BTAA regulation was passed in July. In future, it would be helpful for the government to consult our Office on such matters beforehand.

MANAGEMENT LETTERS

The audit of the Summary Financial Statements is the largest audit in British Columbia. From July 2010 to June 2011, 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, 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, in the form of 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.

Our Office expects management letters to be provided to all government organizations in the government reporting entity (162 entities[6]), and to the Office of the Comptroller General. Therefore, the total number of management letters expected to be provided for 2010/11 is 163. Of those, 150 (92%) had been provided at the time of writing this report (Exhibit 2).

Exhibit 2: Number of management letters provided during 2009/10 and 2010/11

	2009/10		2010/11	
Management letters provided (% total)	153	(91%)	150	(92%)
Management letters not provided at the time of this report	15	(9%)	13	(8%)
Total number of management letters provided	168	100%	163	100%

Source: Compiled by the Office of the Auditor General of British Columbia

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.

We received 92% of the management letters this year, compared with 91% last year. The percentage of management letters provided is slowly improving. When we first began measuring this information for the 2007/08 Summary Financial Statements, the percentage provided was 88%.

MANAGEMENT LETTER ISSUES RAISED IN 2010/11

The 150 management letters provided to date for the 2010/11 fiscal year include a total of 387 issues and recommendations. Of the 387 issues, 217 (56%) pertain to new control concerns identified in the current year's audit. The remaining 170 issues (44%) pertain to items identified in prior audits that were not addressed (or only partially addressed) by management during the current fiscal year.

Last year, we noted that of the 389 issues identified, 133 (34%) pertained to items that had not been addressed. It continues to concern us that management has not resolved so many issues brought forward by their auditors.

These management letter issues focus mainly on improvements needed in the areas of governance and accountability, financial management and disclosure, and information technology. We found that 118 (79%) of the 150 management letters provided contain fewer than five issues. This includes 57 letters (38%) in which no issues were reported at all.

6 The figure consists of 145 government entities (see Exhibit 8 on page 34) and 17 ministries.

Of the total 150 letters provided in 2010/11, only eight had 10 or more issues (see Exhibit 3).

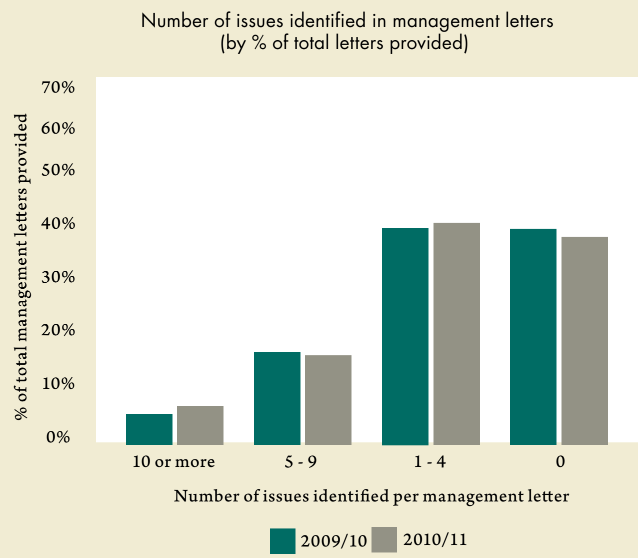
As we note above, of the 387 outstanding issues identified for this year, 217 are new. Exhibit 4 shows a breakdown of the 217 new issues, both by government sector and by the audit entity (our Office or other audit firms) that identified the issues.

Appendix C on page 45 provides a listing of the specific organizations in each sector.

During fiscal 2010/11, our Office performed 44 audits and found 84 new management letter issues (a ratio of 1.91 issues per audit). Other audit firms performed 119 audits and found 133 new issues (a ratio of 1.18 issues per audit). On average, 1.33 new management letter points were issued per audit.

Exhibit 3: Number of issues in each management letter, 2009/10 and 2010/11

	2009/10	2010/11
Number of government entities with:		
10 or more management letter issues	7	8
5 to 9 management letter issues	25	24
1 to 4 management letter issues	60	61
No management letter issues	61	57
Total number of management letters provided	153	150



Source: Compiled by the Office of the Auditor General of British Columbia

Exhibit 4: Number of new issues reported during 2010/11, by sector and by auditor

	Office of the Auditor General		Other audit firms		Total	
Sector	**# of Audits**	**New Issues**	**# of Audits**	**New Issues**	**# of Audits**	**New Issues**
Consolidated Revenue Fund (Ministries)	18	13	0	0	18	13
Health	1	0	18	13	19	13
Education	9	28	80	106	89	134
Natural Resources and Economic Development	8	18	6	0	14	18
Transportation	4	8	1	0	5	8
Social Services	1	0	1	0	2	0
Other Sector	1	12	10	5	11	17
Protection of Persons and Property	1	2	2	0	3	2
General Government	1	3	1	9	2	12
Total	44	84	119	133	163	217

Source: Compiled by the Office of the Auditor General of British Columbia

A significant number of findings relate to the education sector. These 134 findings represent 62% of the new management letter issues raised during fiscal 2010/11. While the number of audits performed in that sector is also high (89 out of 163), the ratio of issues per audit is still above average at 1.51.

CONTROL CONCERNS RAISED IN MANAGEMENT LETTERS IN 2010/11

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 all of last year's control concerns recur as themes in this year's management letters. No new themes were identified.

Exhibit 5 lists the control concerns we identified both this year and in 2009/10. These themes identify the most common control concerns noted in management letters to government entities.

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 governance and accountability, financial management and disclosure, 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 6 shows the number of times each theme was identified in the management letters sent to government entities in 2010/11.

Summarized below are the prevalent themes that were raised in management letters during 2010/11.

Exhibit 5: 2010/11 control concerns identified in management letters, by area

Area	2010/11 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

Source: Compiled by the Office of the Auditor General of British Columbia.

Governance and accountability findings in 2010/11

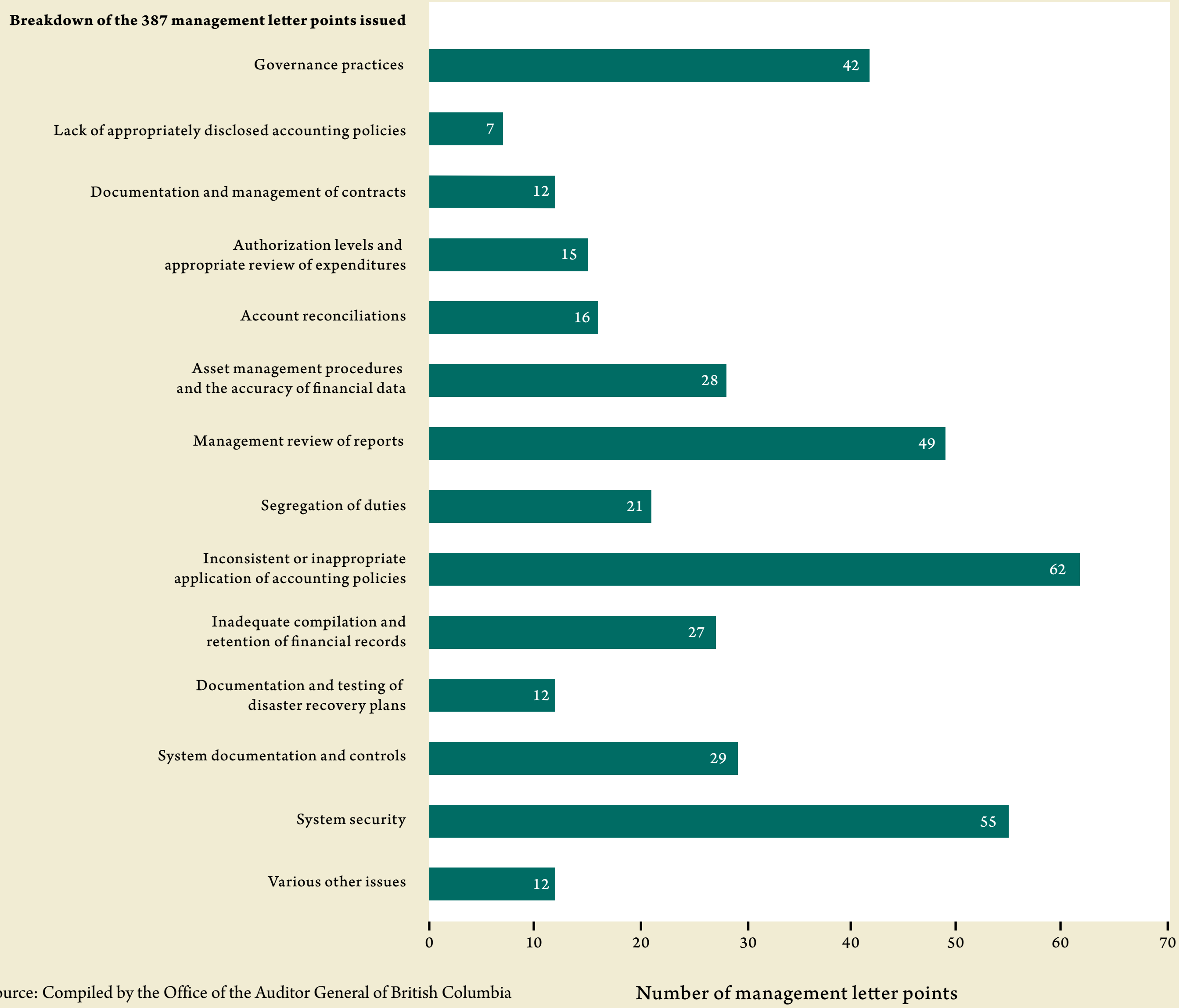
Governance practices

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. An organization with strong governance practices provides 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 2010/11 governance practices issues were identified in 42 instances, 20 of which were unresolved issues from the prior year. Several of these issues are limiting the ability of some government entities to govern effectively. These issues include: policies that are not being reinforced or are missing; incomplete oversight; unclear roles and responsibilities; lack of meetings or communications; and the absence of a whistle-blower program. A recent trend we have observed is a lack of policy regarding the management of significant sums of cash held by organizations so as to maximize return.

Exhibit 6: Number of times themes arose in management letters, 2010/11



Source: Compiled by the Office of the Auditor General of British Columbia

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 to ensure that the entity adheres to them. Clearly defined roles and responsibilities must also exist and be understood.

Financial management and disclosure findings in 2010/11

Lack of appropriately disclosed accounting policies

The accounting policies a government entity adopts will affect its financial position, cash flow and results of operations, all of which become reflected in the entity's financial statements.

The primary purpose of financial statements is to communicate information to users that is relevant to their needs. The usefulness of financial statements is therefore enhanced when an entity includes a clear and concise description of its significant accounting policies as an integral part of the financial statements.

In 2010/11, lack of appropriate disclosure of accounting policies was identified in seven instances, six of which were unresolved issues from the prior year. Examples included not meeting accounting guidelines that require disclosure of major transfers, transactions, balances, secured liabilities and accounting policy changes.

Government entities should fully disclose information in their financial statements. Accounting disclosures should include those required by GAAP, as well as additional information that would 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 2010/11, poor documentation and management of contracts were identified in 12 instances, five of which were unresolved issues from the prior year. Issues in this area included the absence of formal finalized contracts, lack of review of significant contracts to ensure accuracy and adherence to terms, misinterpretation of contract terms, and outdated, unclear and incomplete contract documentation. In a few entities, internal contracts with employees were incomplete, missing or unclear.

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 means there is a greater possibility of unauthorized purchasing, overspending and fraud.

In 2010/11, issues around improper understanding of management authorization levels and appropriate review of expenditures were identified in 15 instances, five of which were unresolved issues from the prior year. Key issues in this area included: entities not adhering to expenditure authorization levels or 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 appropriate levels of expenditure authorization are 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. This in turn can lead to improper representation of the operating performance, erroneous future budgeting and the potential for fraud.

In 2010/11, account reconciliation issues were identified in 16 instances, four of which were unresolved from the prior year. These issues included a lack of reconciliations over accounts, incomplete reconciliations, reconciliations being prepared late, and a lack of 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 an organization maintain a level of proficiency in using its assets to meet its operational needs. An organization's operational assets include inventory and capital assets. Control over these assets requires strict policies and procedures over ordering, warehousing, safeguarding, and conducting financial measurement for reporting purposes.

In 2010/11, asset management procedures and accuracy of financial data were identified as issues in 28 instances, 14 of which were unresolved from the prior year. These control concerns primarily surrounded inventory management, inventory counting and purchasing controls. In addition, we noted issues with respect to controls over cash and cheques held on-site at organizations.

Government entities need to ensure they have adequate policies and procedures in place to effectively manage their organizational assets. Strong asset management procedures facilitate the 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 help identify errors and inconsistencies. Government has a large reporting infrastructure in place to ensure operations are efficient and effective. The inadequate review of reports by management creates the potential for inefficiencies, errors and fraud. Robust policies and procedures over internal reports include review and sign-off by the appropriate personnel.

In 2010/11, management review of reports issues were identified in 49 instances, 19 of which were unresolved from the prior year. The most common issues included lack of management review of internal reports and deficiencies in the 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. That way, functions will be performed independently of one another.

In 2010/11, segregation of duties issues were identified in 21 instances, eight of which were unresolved from the prior year. The issues applied to financial (including posting of journal entries and handling of cash receipts), payroll and purchasing systems.

To reduce the risk of fraud and error, government entities should adopt appropriate policies concerning segregation of duties where applicable.

Inconsistent or inappropriate application of accounting policies

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

In 2010/11, inconsistent or inappropriate applications of accounting policies were identified in 62 instances, 22 of which were unresolved issues from the prior year. The most common issues reported related to the capitalization of expenditures, the amortization of fixed assets, and both the recognition and classification of revenues and expenses.

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 made 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

Government organizations implement various policies and procedures 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 2010/11, inadequate compilation and retention of financial records were identified in 27 instances, 16 of which were unresolved issues from the prior year. All of these matters related to poor or untimely record keeping, which can make reviewing 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 findings in 2010/11

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 prepare for how it would structure its existing resources to minimize the impacts of a possible interruption to government services or loss of data. The plan, a formal document, should be reviewed on a regular basis and updated whenever a significant change to the business or operating system takes place.

In 2010/11, documentation and testing of disaster recovery plans issues were identified in 12 instances, seven of which were unresolved from the prior year. These control concerns pertained to 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 then used to drive the development of comprehensive disaster recovery plans.

System documentation and controls

Government entities rely heavily on information technology (IT) 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. Strong IT systems are also supported with clear and robust system documentation and user guides.

In 2010/11, system documentation and control issues were identified in 29 instances, 13 of which were unresolved from the prior year. Some of the more common control concerns identified were a lack of an overall IT strategy, inadequate system design and control procedures, lack of adequate system documentation to support the understanding and use of the system by its users, and lack of review of system event logs and 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 IT as a means of streamlining their operations. The information processed in IT systems and services must be correct and the data secure. Without adequate system security, there is an increased risk of incorrect or fraudulent transactions occurring.

In 2010/11, system security issues were identified in 55 instances, 24 of which were unresolved from the prior year.

Many entities were found to have inadequate passwords (for example: missing periodic changes and minimum length requirements). A lack of password complexity and expiration terms increases the risk of unauthorized access to the IT system. Numerous instances of inappropriate internal user access rights were also observed, and many entities lacked a periodic review process for checking whether employee access rights to areas of the IT system have been appropriately authorized or are warranted for the job function of individual users. Inadequate controls over physical access to computers and the safeguarding of file server rooms were also noted.

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

CLASSIFICATION OF DEBT

Government reports its debt in the Summary Financial Statements and in the Provincial Debt Summary as either taxpayer-supported or self-supported. The distinction between them is not defined in generally accepted accounting principles (GAAP). Rather, they are defined in government policy.

The distinction between the two types of debt is important to government, as it believes readers of the financial statements view self-supported debt to be "good debt" that is supported by profitable activities, and taxpayer-supported debt to be supported by taxation revenues.

Government's classification of debt is generally based on the nature of the organization in which the debt is held rather than the nature of the debt itself. As a result, the classification of the debt is not always consistent with the nature of how the actual debt is being supported within an organization.

Some organizations that are considered taxpayer-supported by government have some debt that is, in fact, self-supporting. For example, while universities are considered to be taxpayer-supported organizations and their debt is considered taxpayer-supported, most have student residences financed with rental revenues that fully support the related debt.

It is also relevant to consider that any debt incurred by the government will be repaid by a combination of taxes, user fees and other revenues. The financing of various projects (i.e. whether or not user fees are applied) is a matter of government policy. The financing of a bridge, for example, could come just as easily from taxes as it does from user fees, or a combination of the two. Therefore, while the distinction between taxpayer-supported debt and self-supported debt may be important to government, it may not be as important to the citizens of British Columbia who must pay for the bridge one way or the other.

A user of the financial statements should expect that debt is classified in accordance with its nature. For the information provided in financial statements to be useful, it must be capable of being understood by users. Therefore, given that government does disclose its debt as either self-supported or taxpayer-supported, it should make the definition clear, better describe the debt according to its nature, and classify the debt accordingly.

As in past years, we have noted that warehouse debt is classified as self-supporting debt without regard to the nature of the debt itself and whether it is actually self-supporting. Warehouse debt is a government program that takes advantage of market opportunities to borrow in advance of requirements. These funds are invested until they are needed by the government or its Crown corporations and agencies. Government has stated that classifying warehouse debt as 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, however, warehouse debt would be more appropriately disclosed as taxpayer-supported debt. It is rare that the investment earnings are more than the interest expense. In reality, the interest costs are generally well in excess of any income earned, so there is a net carrying cost. This means the warehouse debt is not completely self-supporting. As well, the warehouse debt is often subsequently used by central government or by government organizations that are not self-supporting.

RECOMMENDATION #1 ***We recommend that government revise its definitions of self-supported and taxpayer-supported debt to better describe the nature of the debt.***

RECOMMENDATION #2 ***We recommend that government include the debt of the warehouse borrowing program with taxpayer-supported debt and not with self-supported debt.***

DISCLOSURE OF GAMING GRANTS

On the statement of operations in the Summary Financial Statements, government discloses its expenses according to sector: health, education, social services, natural resources and economic development, protection of persons and property, transportation, general government, interest and "other" sectors.

All of the gaming grants made by government are classified in the "other" sector. In our view, the grants should be classified according to the purpose of the grant. In this way, the financial statements would properly reflect the usage intended by government. In March 2010, when it was announcing the funding for fiscal 2010/11 community gaming grants, government stated that funding would be targeted to groups that address public safety, human and social services, youth programs and parent advisory councils. Each group was given a date range within which its application for funding should be made. As well, government announced the anticipated funding allocation for each of these groups, and then during the year announced the actual amounts given out.

In 2010/11, government distributed a total of $134 million in gaming grants. These were all incorrectly allocated to the "other" sector. If they had been classified according to the sectors noted by government, they would have been classified as follows:

Sector	Grant provided ($ millions)
Social Services	77
Other	35
Education	15
Protection	6
Natural Resources and Economic Development	1
Total	134

RECOMMENDATION #3 ***We recommend that gaming grants be classified in the statement of operations according to the purpose of the grant provided by government.***

ACCOUNTING FOR TAX APPEALS

The Province administers a number of taxes, many of which are based on consumption or the use of natural resources. Examples are social service tax (PST), forest revenue tax, property transfer tax, logging tax, mineral tax, and petroleum and natural gas tax.

Provincial taxpayers can appeal taxation decisions such as audit and other tax assessments, penalties, interest, and denied refunds to the Minister of Finance. The appeals process is composed of many stages, but includes the Tax Appeals and Administrative Services Branch (commonly called the Appeals Branch) reviewing an appeal case and making a recommendation to the Minister on whether or not to accept the appeal.

Beginning in fiscal 2010/11, the dollar value of tax appeals that have been received but not yet reviewed by the Appeals Branch (tax appeals inventory) is disclosed in the Contingencies and Contractual Obligations note (note 25) to the Summary Financial Statements. However, government does not recognize a liability for a tax appeal until a full review of the appeal has been completed by the Appeals Branch.

GAAP requires that a liability be recognized in the Summary Financial Statements when it is likely that a liability exists and a reasonable estimate of the liability can be made.

While the outcome of any individual tax appeal is uncertain, we have observed that a consistent percentage of tax appeals – 26% over the past four years – have been decided in favour of the taxpayer. Thus, even if a complete assessment has not been made by the Appeals Branch, it is likely that a certain number of appeals will be allowed and therefore a reasonable estimate of the liability for tax appeals can be made. For this reason, a liability for tax appeals inventory should be accrued in the Summary Financial Statements.

Applying the 26% average percentage to the current year-end tax appeal inventory of $105 million provides what we believe is a reasonable estimate of the liability for tax appeals: $27 million.

RECOMMENDATION #4 ***We recommend that government record an estimate of tax appeals that have not yet been assessed as an accrued liability in the Summary Financial Statements. Because the accrual will be based on an estimate, government should also disclose the amount of uncertainty around the estimate in the Measurement Uncertainty note (note 2) to the Summary Financial Statements.***

DISCLOSURE OF CHANGES IN BUDGETS

The comparison of government's budgeted to actual financial results provides key accountability information about the government's performance in achieving its operational and spending plans. Under Canadian Public Sector Accounting Standards, the statement of operations should present a comparison of the results for the accounting period with those originally planned. Planned and actual results should be presented using the same scope of activities and be done on a consistent basis of accounting.

In circumstances where errors in the budgeted amounts are found, it is necessary to correct the amounts and provide a reconciliation of the restated information to the information originally presented in the fiscal plan.

When government issued the Estimates for the fiscal year ending March 31, 2012, on May 3, 2011, page 2 noted there were restatements of the 2010/11 Estimates that would affect the budget amounts to be disclosed on the Summary Financial Statements' statement of operations. However, the budget presentation for fiscal 2010/11 was not restated to reflect the correction (which related to accounting for revenues of the Evergreen Rapid Transit Line).

As a result, the Estimates amount in the statement of operations overstated both revenues and expenses by $37 million.

RECOMMENDATION #5 ***We recommend that when government's planned Estimates are not prepared on a basis consistent with that used to report the actual results, the planned results be restated. As well, a reconciliation should be provided that shows the amendments made from the original Estimates to the amounts reported in the Summary Financial Statements.***

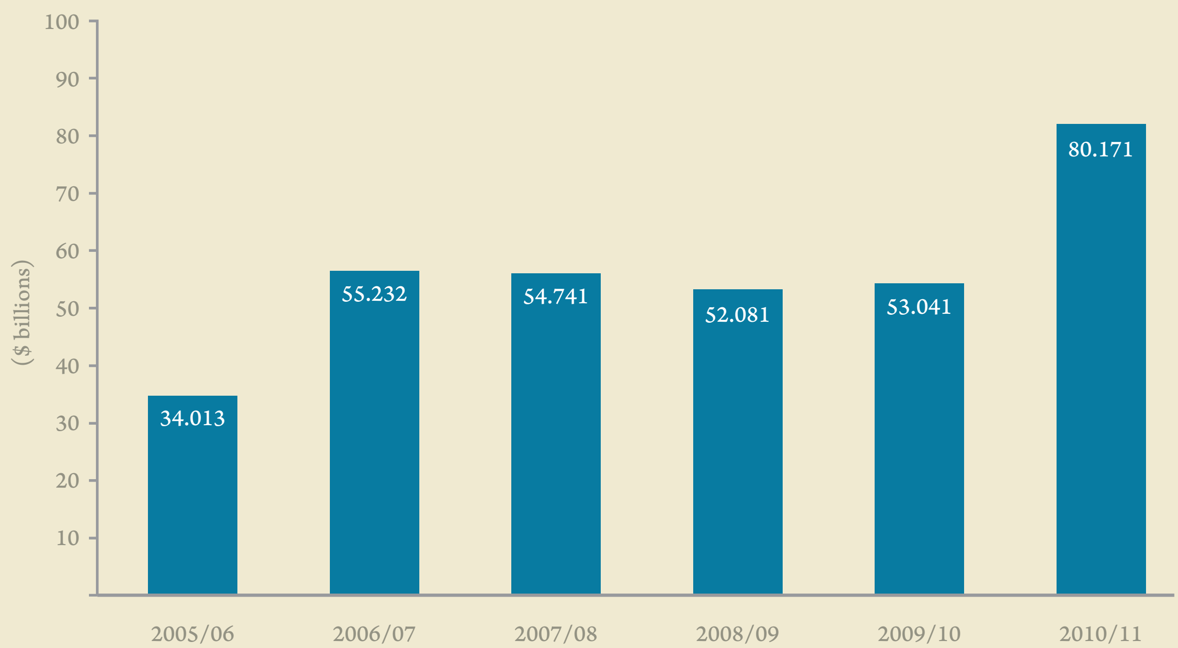
TRANSPARENCY AND UTILITY OF CONTRACTUAL OBLIGATION DISCLOSURES

One issue we have been discussing with government over the last few years is its disclosure of contractual obligations.

Government regularly enters into long-term contractual agreements with external organizations to provide goods or services to the public. These contractual obligations span many aspects of government's operations, and represent important, long-term commitments by government.

As Exhibit 7 shows, these contractual obligations have exceeded $50 billion since 2007, and increased to $80 billion in 2011.

Exhibit 7: Total reported contractual obligations of government, fiscal years 2005/06-2010/11 ($ billions)



Source: Summary Financial Statements, 2005/06-2010/11.

Most of the 2011 increase is due to BC Hydro entering into long-term energy purchase agreements with independent power producers. However, few details on these agreements are provided by government.

Contractual obligations have a significant impact on the degree of service delivery, and on how these services are delivered now and into the future. Furthermore, the expected payment streams associated with these obligations directly impact the remaining amount of discretionary funds available to government to meet future needs.

Government discloses its contractual obligations in note 25 of the audited Summary Financial Statements, and in an unaudited supplementary schedule on government's website (available at www.fin.gov.bc.ca/ocg/pa/10_11/Contractual_Obligations.pdf). Note 25 meets the minimum disclosure requirements defined by Canadian generally accepted accounting principles (GAAP). The supplementary schedule, although unaudited, even exceeds the minimum Canadian GAAP disclosure requirements.

Given the importance of this topic, we considered whether the information requirements of stakeholders were being met by government's existing contractual obligation disclosures and, if they were not, what additional disclosures could be provided.

We noted that:

- Government is not providing readers with ready access to relevant contract details to help them better understand and evaluate the nature of significant contracts being entered into.
- Government's audited and supplemental contractual obligation disclosures do not include comparative figures to help readers see the trends of these obligations over time.
- Government does not clearly describe the rules it uses to compile the supplemental contractual obligation disclosure, or explain how these rules could impact readers' interpretation of results. For example, the supplemental contractual obligation disclosure does not reflect the anticipated costs of continuing to provide a service after the existing contract term has expired.
- The supplemental contractual obligation disclosure only provides the expected annual contract payments for each of the upcoming five years; after that point, all future expected contract payments are aggregated into a single "20XX and beyond" figure – an approach that may deny some readers important information, as many of these contractual agreements extend well beyond the five-year window. The majority of disclosed contract payments (70%) occur after the fifth year. A further breakdown of the "beyond" years would provide more useful information.
- Contractual obligation supplemental disclosures are not being provided in an electronic format that would readily facilitate further analysis.

To improve its supplementary disclosure of contractual obligations, we make the following recommendations:

RECOMMENDATION #6 ***We recommend that government provide more complete disclosure of the anticipated payments to be made after five years so that stakeholders can fully appreciate the duration and timing of these obligations.***

RECOMMENDATION #7 ***We recommend that government expand its existing supplemental contractual obligation disclosures to ensure that stakeholders have access to information they might find significant. Disclosures should include:***

(a) significant terms and conditions of the contracts that could impact expected future cash inflows or outflows and service delivery continuance, key renewal and termination options, and any other rights or obligations that could have a material impact on the contract or on users of that contracted service;

(b) more complete descriptions of the rules used to compile the supplementary contractual obligation disclosure, as well as any significant limitations these rules could impose on the use of the information; and

(c) comparative contractual obligation information to help readers understand trends in government's contractual obligations.

RECOMMENDATION #8 ***We recommend that government provide the supplemental contractual obligation disclosure information to the public in a format that is easy to use and that facilitates further stakeholder analysis and evaluation of results.***

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 then-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.

However, while the government reporting entity should include all entities that are controlled by government, including those entities' subsidiaries, in practice it is not always clear which organizations are under government's control.

Part of the problem is that there are varying degrees of government control. However, in the end, control is either assessed as existing or not.

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 government 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. If a change in legislation is required then control may not exist.

The organizations that make up the government reporting entity can change each year as new organizations are created or dissolved, or as government includes or removes itself from governing boards. Government provides a list of the entities included in the Summary Financial Statements (see the Public Accounts, starting on page 81). This does not include the numerous subsidiaries that are consolidated into the financial statements of those listed.

For fiscal 2010/11, a number of changes occurred in the government reporting entity. These are reflected in the Summary Financial Statements.

- In the health sector, the British Columbia Health Services Purchasing Organization is a new entity that is being included in the Summary Financial Statements for the first time. The Shared Services Organization Administration Society stopped operating as a separate organization, but has become part of the Provincial Health Services Authority.
- The Institute of Indigenous Government in the education sector was wound up and therefore is no longer included in the Summary Financial Statements.
- Tourism British Columbia in the natural resources and economic development sector was wound up as a separate organization, and the tourism portfolio is now included in the Ministry of Jobs, Tourism and Innovation.
- In the other sector, the British Columbia Public School Employers' Association, Community Social Services Employers' Association, Health Employers' Association of British Columbia and Post-Secondary Employers' Association are new entities that have been included in the Summary Financial Statements for the first time this year. The British Columbia Arts Council was wound up and included in the Consolidated Revenue Fund. The Homeowner Protection Office was also wound up during the year.
- The British Columbia Transmission Corporation, a modified equity enterprise in the natural resources and economic development sector, has become part of the British Columbia Hydro and Power Authority.
- The British Columbia Railway Company, a modified equity enterprise in the transportation sector, became a subsidiary of the BC Transportation Financing Authority.

Sometimes an organization that was created some years previously but was overlooked in the consolidation of entities will come to our or the government's attention. This was the case with the Trades Training Consortium of British Columbia.

Given that this society is governed by presidents of colleges and universities included in the education sector, and that the society receives funding from the government, in our view the organization is controlled by government. We noted that it has not been included in the Summary Financial Statements this year.

The $5 million in government funding it received was paid by government after year-end and therefore has no significant impact on the Public Accounts. The omission of this entity was not enough to cause us to provide a qualification of the audit opinion on the Summary Financial Statements.

THE ROLE OF MANAGEMENT AND THE AUDITOR IN PROTECTING GOVERNMENT FROM FRAUD

All organizations, whether in the public or private sector, risk falling victim to fraudulent activity.

Fraud occurs in many forms, with damages that can go far beyond financial losses. It may be perpetrated by internal (e.g. employees) or external parties (e.g. contractors), or in collusion between internal and external parties (e.g. procurement and contract fraud). While fraud is typically perpetrated with the ultimate goal of financial gain, it may also involve unethical behaviour designed to mislead or misinform.

Damages from fraudulent activity can sometimes extend beyond financial loss and may result in irreparable loss of public confidence and the reputation of the organization.

From an audit perspective, we are concerned with two types of misstatements resulting from fraud: the misstatement of financial statements as a result of fraudulent financial reporting, and the misappropriation of assets. As part of the provincial audit process, auditing standards require us to obtain reasonable assurance that the Province's financial statements, taken as a whole, are free of material misstatement.

However, because of the inherent limitations of an audit, some misstatement of financial statements may go undetected, especially if fraud is involved, as perpetrators often take extra measures to conceal the act. Therefore, even when an audit is planned and performed properly and in accordance with applicable standards, fraud may go undetected.

As required by Canadian auditing standards, in each of our audits we consider the risk of fraud at the overall financial statement level, as well as at the individual account balance or transaction level. When conducting our audits, we maintain professional skepticism throughout the audit and recognize the possibility that material misstatement due to fraud could exist.

It is well understood that the responsibility to prevent and detect fraud lies with those individuals who are charged with the governance and management of an organization. It is also the public's expectation that their government is taking the appropriate steps to safeguard public resources from such threats.

Responding to threats of fraud requires governing bodies and senior management to set an appropriate tone at the top so that the right message is relayed throughout the organization. It is that group's responsibility to put in place proper processes to identify, assess and respond to the risk of fraud from both internal and external sources. A commitment by management to that end must be reinforced through the active oversight of those charged with governance.

Fraud does happen in the public sector. For example, in May 2011 the Ministry of Health estimated that healthcare fraud resulting from the inappropriate use of CareCards to access health services could cost the Province $260 million each year. Having effective fraud management processes in place is crucial for a strong line of defense against the inappropriate use of public resources.

In August 2010 we published *Aspects of Financial Management,* which included the report "Managing Fraud Risks in Government." We noted that there was no generally accepted fraud risk guidance available or in use across the provincial government, nor was there any centrally coordinated oversight or reporting. As a result, we drafted good-practice principles for fraud risk management, along with a list of common fraud indicators, and recommended that government adopt a comprehensive fraud risk management plan based on the principles that we had provided.

Furthermore, in June 2011 we issued a report on *The Status of Enterprise Risk Management in Government Ministries of British Columbia*, which included several recommendations for the government's enterprise risk management program. As indicated in that report, effective risk management, including managing the risk of fraud, is integral to the government's success in delivering its mandate.

Recognizing the risk inherent in government's activities (such as the pressure to meet budgetary requirements and reduce costs, and the sensitivity of data and information stored in government's systems), it is imperative that the government continue its efforts in these areas.

In the coming year our Office will continue to assess how well the government manages the risk of fraud and demonstrates probity in managing public resources.

WORKING CAPITAL MANAGEMENT

In previous reports we have commented on government's management of working capital. We noted that government should manage its surplus cash and investments effectively, and maintain control over other aspects of working capital management. This includes the timely collection of accounts receivable and the appropriate payment of accounts due. Managing working capital effectively can reduce government's borrowing requirements and the cost of servicing debt.

In August 2010 our Office released *Aspects of Financial Management*, a report summarizing the findings of four separate audit projects examining financial management by the provincial government. Three of the topics relate to the management of working capital.

The first project, "Management of Working Capital by Colleges and School Districts," found that an excess of working capital has developed over time, and should be addressed by government. The other two projects, "Year-end Government Transfer Expenditures" and "Infrastructure Grants," found that government payments were often provided in advance of recipient need, pointing to the inefficient management of working capital. Good financial management by government includes making payments when the funds are needed, and not before.

Our Office plans to continue monitoring the management of working capital and will periodically follow up on government's progress in responding to the recommendations in the report released last summer. In our audit of this year's Summary Financial Statements, we noted that as at March 31, 2011 school districts had a balance of cash and short-term investments of $859 million (2010: $941 million) and colleges had a balance of $229 million (2010: $241 million). In our view, these balances are still in excess of what the entities require to operate.

Overall, government's balance of cash and cash equivalents, and temporary and warehouse program investments, increased between 2010 and 2011 from $2.9 billion to $3.1 billion.

CARBON NEUTRALITY

In 2007 the provincial government passed the *Greenhouse Gas Reduction Targets Act*. A requirement of the 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 them where possible, and offsetting the remainder through the purchase of carbon offsets.

In March 2008 government created a new Crown corporation called Pacific Carbon Trust (PCT). The purpose of PCT is to deliver B.C.-based greenhouse gas offsets on behalf of the Province, 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 that PCT has agreed to serve.

On June 30, 2011, the provincial government announced the achievement of carbon neutrality for calendar year 2010, as defined in the regulation. The volume of carbon offsets required to be purchased or contracted to achieve carbon neutrality, as determined by government, was approximately 730,000 tonnes. This represents a significant increase over the volume purchased in 2009 (approximately 10,000 tonnes), when government was required to offset business travel only.

Government and public sector organizations have recently developed and implemented tools and processes, including quality assurance and controls, for collecting energy, fuel and paper consumption data, in addition to business travel data for government. This data is used to determine greenhouse gas emissions and ultimately the amount of carbon offsets required in order to achieve carbon neutrality each year.

PCT now purchases more than 50% of all carbon offsets sold in British Columbia, and therefore plays a significant role in the development of B.C.'s carbon market. The associated market for trained assurance professionals who validate project plans and then verify carbon offsets is also expanding with the increase in PCT's purchasing requirements and the development of the North American carbon market.

As carbon reporting and the procurement of carbon offsets are ground-breaking in the province, there are risks as would be expected with any new undertaking. These may include risks associated with a developing and unique market, or risks present with any information system early in its development. Our Office is continuing to monitor the development of the carbon market and emissions reporting processes in order to inform future performance audit work over carbon neutrality.

EARLY ADOPTION OF PUBLIC SECTOR ACCOUNTING BOARD STANDARDS: IMPACT ON THE BC TRANSPORTATION FINANCING AUTHORITY

In December 2009 the Public Sector Accounting Board (PSAB) made amendments to the introduction of the Public Sector Accounting Standards to clarify what types of government organizations are required to follow the *Public Sector Accounting Handbook* for fiscal periods beginning on or after January 1, 2011.

The British Columbia Transportation Financing Authority (BCTFA) elected to adopt PSAB standards early, effective for its fiscal year starting on April 1, 2010. By adopting these standards, the BCTFA had to make a number of accounting policy adjustments because of differences between the new standards and the accounting framework previously followed by the organization.

The most significant accounting treatment differences were for: funding received from the Government of Canada under cost-sharing agreements for transportation infrastructure projects; the transportation assets that were transferred to BCTFA from the provincial government; and capital project contributions from other provincial agencies.

Under the previous accounting framework, the policy was to record these types of transfers as a liability (deferred capital contributions) and recognize the transfers as revenue in the statement of operations on the same basis as the related assets were depreciated. As a result, there was no impact on net earnings for the year.

Now, under PSAB, these transfers must be recognized as revenue in the period they are received unless there are stipulations imposed by the transferring entity that would require the contribution to be repaid if a stipulation is breached. These stipulations create an obligation that meets the definition of a liability. In this case, the PSAB standards require that revenue be recognized as the liability is settled rather than as the related assets are amortized.

BCTFA, in preparing its first financial statements in accordance with PSAB, decided not to follow the PSAB standard for government transfers, but instead to follow the previous standard. This prompted the Auditor General to issue a qualified audit opinion on the 2011 financial statements of BCTFA.

If capital contributions had been properly recognized in accordance with PSAB, deferred capital contributions as at March 31, 2011 would have been reduced by $1,702 million (March 31, 2010: $1,762 million; April 1, 2009: $1,876 million). Accumulated surplus as at March 31, 2011 would have been increased by $1,702 million (March 31, 2010: $1,762 million; April 1, 2009: $1,876 million). Revenue on the statements of operations would have been reduced by $60 million (2010: $113 million) and the annual deficit would have increased by $60 million (2010: $113 million).

ACCOUNTING STANDARD CHANGES NOT YET IMPLEMENTED

The accounting standards set by PSAB continue to change. Amendments are regularly made and new standards are often developed.

However, whenever standards are changed or created, 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 standard changes that have been approved but are not yet in effect. Other planned amendments are in the consultation phase, and the scope of new projects is being developed. The status of changes to PSAB accounting standards is documented on its website (see www.psab-ccsp.ca).

Of these, the changes that may have a significant impact on future reporting in the Summary Financial Statements are:

- government transfers;
- financial instruments; and
- concepts underlying financial performance.

Government transfers

In December 2010, PSAB approved a final standard to replace the existing accounting standard for government transfers. Early adoption of this standard is permitted before the mandatory effective date of April 1, 2012. The new standard addresses how a transferring government or a receiving 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 revised standard recommends that transfers be accounted for as revenue in the period in which they are received, unless there are stipulations attached to the transfer that create a liability. In that case, the transfer revenue can be deferred. For example, if the transferor specified the purpose for which the funds were to be used, and stated they had to be repaid if not used in that manner, then any unused funds at the end of year would be recorded as deferred revenue. This means that the stipulation of the transfer alone (or the stipulation of the transfer taken together with the actions and communications of the Province before the Summary Financial Statements date) could create an obligation that meets the definition of a liability.

Thus, each transfer from the federal government will need to be assessed to determine if a liability has been created that will allow unused funds to be deferred.

Financial instruments

The new financial instruments standard was approved by PSAB in March 2011. It has an effective date of April 1, 2012, for government organizations and April 1, 2015, for governments (i.e. for the Summary Financial Statements). Earlier adoption is permitted.

In general, some financial instruments (e.g. derivatives) and portfolio instruments in equity instruments that are quoted in an active market will be measured at fair value. Other financial instruments may be reported at fair value or continue to be reported at cost or amortized cost. The measurement of various financial instruments will depend on the accounting policies chosen by government.

The financial instruments standard provides comprehensive guidance on the recognition, measurement, presentation and disclosure of financial instruments so that users can be given sufficient and comparable information to understand the extent and nature of the financial instruments used by the Province. For example, unrealized gains and losses associated with changes in fair value of financial instruments will not be reported on the statement of operations. These fair value changes will be reported on a new statement of remeasurement gains and losses presented in the Summary Financial Statements. This new statement will also be used to report other comprehensive income associated with the consolidation of government business enterprises and government business partnerships.

In May 2011, PSAB set up a task force to review the existing conceptual framework in conjunction with the work being undertaken by the International Public Sector Standards Board. The conceptual framework in the existing accounting standards identifies and discusses the basic qualities of information that are effective in meeting the needs of users to help them make decisions and assessments concerning government financial operation and management. This means that for information to be useful, it must be relevant to the needs of the users, reliable, comparable, understandable and clearly presented.

Concepts underlying financial performance

The results of the "concepts underlying financial performance" project may have a significant impact on future reporting in the Summary Financial Statements. Changes in measuring financial performance may impact existing and future accounting standards. This project may also facilitate the Canadian and international accounting standards to become more similar.

This is a very brief summary of complex accounting standards. We will continue our discussions with government as it reviews and modifies any of its accounting policies, and help ensure the appropriate accounting treatments for these accounting standard changes are included in the Summary Financial Statements.

COMPOSITION OF THE GOVERNMENT REPORTING ENTITY

The Summary Financial Statements as at March 31, 2011 are a consolidation of 145 government organizations (Exhibit 8) plus the Consolidated Revenue Fund, which is composed of eight legislative offices, the legislative assembly, the Office of the Premier and 17 ministries. Some of the 145 government organizations in Exhibit 8 are themselves the consolidation of several other subsidiary organizations.

Exhibit 8: Government entities, by type, in the government reporting entity, 2010/11

Entity type	Number of entities
Crown corporations	43
School districts	60
Universities	11
Colleges	14
Health authorities	6
Hospital societies	10
Other organizations	1
Total	**145**

Source: Derived from the reporting entity schedule in the 2010/11 Summary Financial Statements.

For this reason, the actual number of audits carried out is much greater than the number of organizations listed in Exhibit 8. All of these together make up the "government reporting entity" and set the scene for a very large and complicated accounting and audit process.

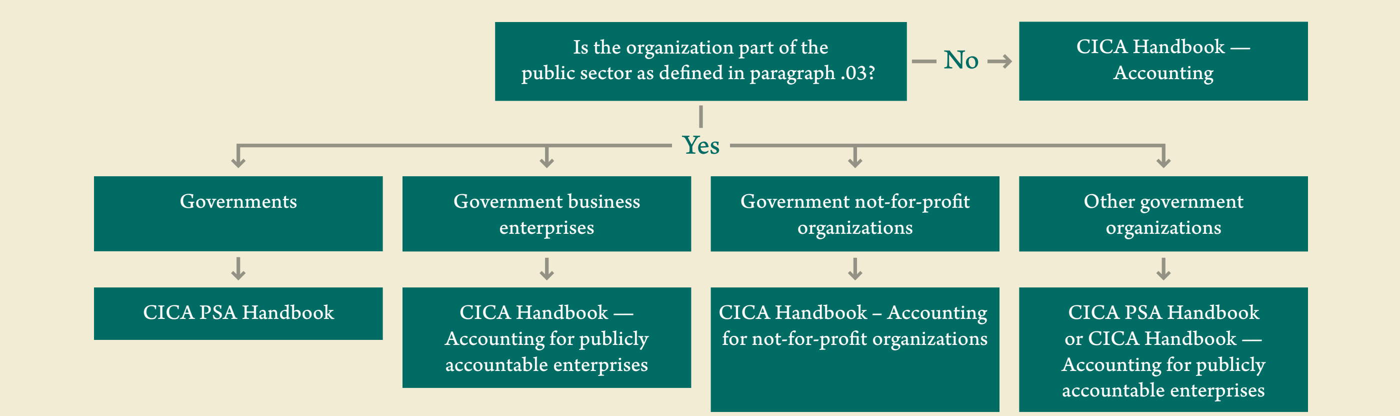
GOVERNMENT'S FINANCIAL REPORTING FRAMEWORK

Under the *Budget Transparency and Accountability Act* (BTAA) and regulations in place as at March 31, 2011, the Province's financial statements are publicly reported in accordance with generally accepted accounting principles (GAAP) for senior governments in Canada.

On page 12 we discuss how accounting standards are changing, and on page 16 we describe how government has responded to those changes by amending the BTAA. It is important to note that the standards that are applicable in fiscal 2010/11, as described in this section, are different than the standards that will be applicable in the future.

In the standards applicable as at March 31, 2011, individual organizations in the public sector had a choice between reporting their financial results using Public Sector Accounting Board (PSAB) standards or those issued in the *CICA Accounting Handbook*. Within the CICA Handbook, entities have a choice of reporting under the standards for publicly accountable enterprises or not-for-profit organizations. Therefore, for fiscal 2010/11, organizations within government could report their individual financial statements under

Exhibit 9: Canadian GAAP basis for preparing public sector financial statements, 2010/11



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.

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 9).

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 145 audited financial statements are combined with the audited accounts of the Consolidated Revenue Fund to create the consolidated Summary Financial Statements. The Auditor General then audits the statements and provides an audit opinion.

Exhibit 10 shows how all of the 145 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 (136 out of 145) are included in the Summary Financial Statements using a line-by-line consolidation method. Under this method, the accounting policies of each individual organization are converted 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 result in 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 revenues from outside of government.

Nine government business enterprises (GBEs) have been consolidated using the modified equity method, although in our view only eight entities should be consolidated using this method (see key issue #1 on page 10 regarding the full consolidation of the Transportation Investment Corporation, and see Appendix C, footnotes 4 and 5).

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, as opposed to each financial statement line item.

AUDITING THE SUMMARY FINANCIAL STATEMENTS

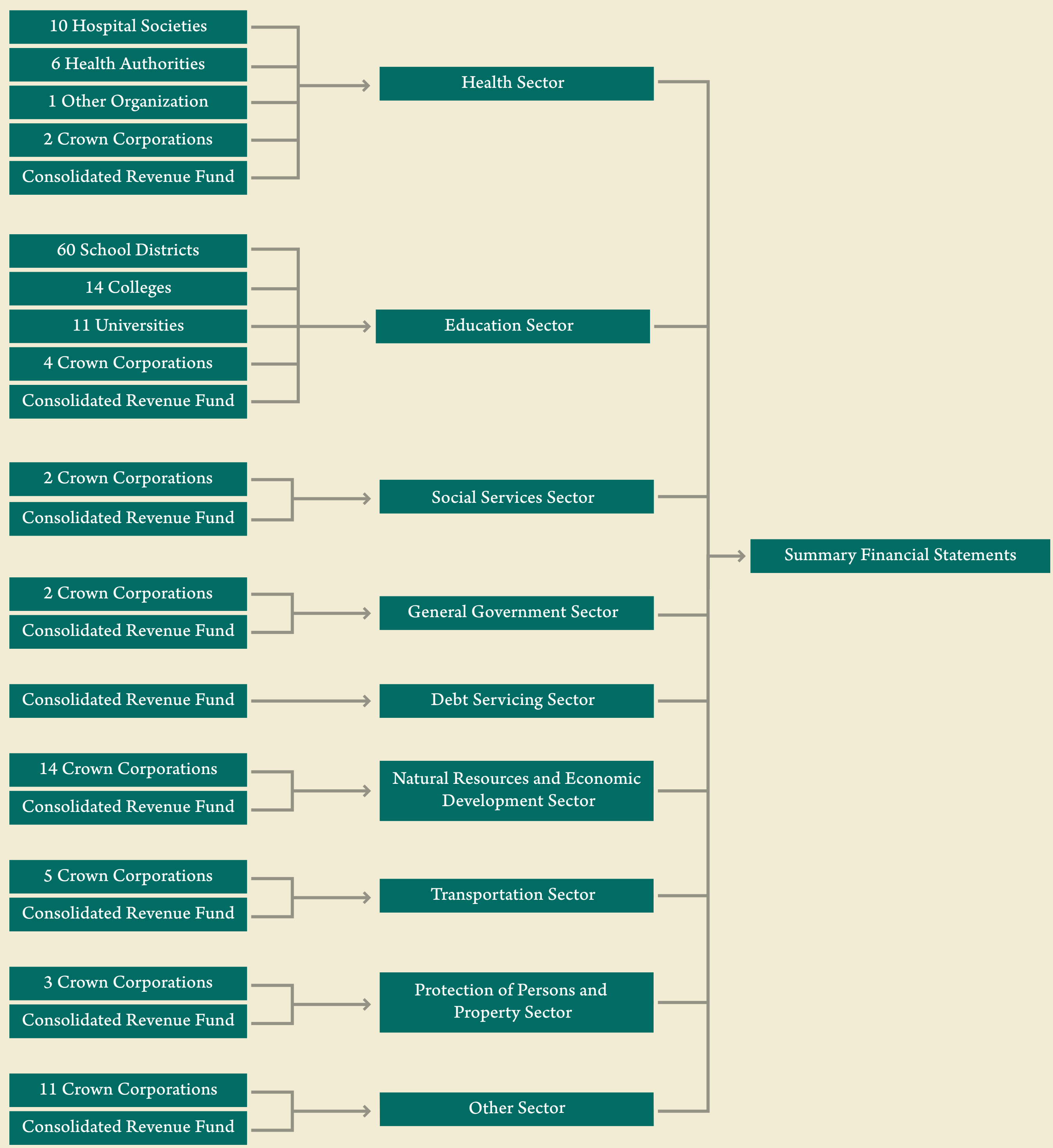
The Office of the Auditor General was established to carry out the audit of the provincial government’s financial statements. Under the *Auditor General Act*, the Auditor General must report each year, in accordance with Canadian generally accepted auditing standards (GAAS), to the legislative assembly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

New Canadian Auditing Standards were implemented during this fiscal year. For many auditors this would require a great deal of additional work as the new standards have specific requirements, particularly for the auditors of group, or consolidated, 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 Public Accounts and is designed to ensure the Auditor General maintains sufficient audit coverage related to the audit of the Summary Financial Statements.

Exhibit 10: Consolidation of government organizations into the Summary Financial Statements, 2010/11



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

Source: Derived from the reporting entity schedule in the 2010/11 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.

Maintaining sufficient knowledge of the government reporting entity in order to perform the audit requires substantial resources from our Office. The audit coverage plan is carefully 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, these auditors' 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.

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 whom 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.

In fiscal 2009, 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 $1.4 billion (before the forecast allowance), so there was not much concern that a projected deficit would turn into a surplus, although the actual result was a deficit of only just over $300 million. 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, even though it may 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.

This year, because of the lower amount of overall error found, the Auditor General's opinion on the Summary Financial Statements contained two fewer qualifications than it did in the previous year. As discussed on page 12, we also note that if errors increase in the future, then the reservations could be reinstated.

In British Columbia, the government, through the *Budget Transparency and Accountability Act*, prepares 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.

UNADJUSTED ERRORS

As noted above, it is important for an auditor to track the amount of error found in the financial statements as this will impact whether or not the auditor can provide an unqualified audit opinion. The number, and type, of errors found can also indicate how well management's financial statement preparation processes are working.

In the course of completing the consolidation of the Summary Financial Statements, we discovered 61 errors, of which 32 were corrected by government. The 29 uncorrected items include the consolidation of the Transportation Investment Corporation (TIC), for which we have qualified our opinion, and seven other items where government disagreed with us on the appropriate accounting treatment. Government considered the remaining 21 items not significant enough to be adjusted and, in some cases, to have been reported to its staff too late in the process to be adjusted.

We also found 16 errors relating to how items were disclosed in the financial statements. Government corrected six, disagreed with our proposed disclosure on another six and considered the remaining four not significant. As well, the auditors of the government organizations reported 13 significant errors to us that had not been corrected. We expect government to want to adjust all errors found.

Apart from government's failure to fully consolidate the Transportation Investment Corporation, which resulted in the qualification to our audit opinion (discussed above), we did not consider that any other individual uncorrected error, or the sum of them all, were significant enough to result in another qualification this year.

In making that determination, we also considered the reasons behind the qualifications issued on two audit opinions of government organizations (the BC Transportation Financing Authority and the BC Academic Health Council). Qualifications of the audit opinions of government organizations are a serious matter, and should be brought to the attention of the Minister. However, in our view the effect of the qualifications of these organizations on the Summary Financial Statements was not quantitatively significant.

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 2010/11 Public Accounts, the Auditor General identified one area of reservation which is outlined in this report.

Reservation of Opinion

- 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.

Other Recommendations to Government

In addition to the reservation 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.

Classification of Debt

RECOMMENDATION: ***Government revise its definitions of self supported and taxpayer supported debt to better describe the nature of debt.***

Accounting standards do not provide guidance on describing the nature of debt. The long-standing practice of British Columbia is to define debt as taxpayer-supported (that debt which will be paid for by tax revenue), and self-supported (that debt which will be paid for by user fees charged by commercial Crown agencies on goods and services).

This basis of defining the nature of debt remains relevant because it provides a clear description to financial statement users of how much debt must be paid for through future taxation as opposed to debt that will be paid for through the commercial activities of government business enterprises. A detailed definition of both taxpayer-supported and self-supported debt is provided in note 1 (d) of the 2010/11 Public Accounts.

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

When Warehouse Debt is presented and disclosed in the Public Accounts it is on a basis consistent with the province's stated accounting policy, and is clearly described in Note 1 to the financial statements. Warehouse debt has not been presented in the Public Accounts for 2010/11 or 2009/10 because there was no balance outstanding.

Disclosure of Gaming Grants

RECOMMENDATION: ***Gaming grants be classified in the statement of operations according to the purpose of the grant provided by government.***

All expenses are disclosed by sector describing the objective or purpose of the transferor rather than that of the recipient. It would not be appropriate to selectively attribute transfers of a specific program to the function representing the recipient's area of activity or use of funds.

Under the *Gaming Control Act*, eligible charitable organizations may apply for a grant consistent with the conditions and purposes described in legislation. The objective or purpose of Government through this program is to distribute the proceeds of gaming to charitable organizations in accordance with the legislation. The *Gaming Control Act* does not provide government the discretion to allocate grants in preference of one sector over another.

Transfers made for this purpose are correctly reported in the "other" sector as defined by Statistics Canada.

Accounting for Tax Appeals

RECOMMENDATION: ***Government record an estimate of tax appeals that have not yet been assessed as an accrued liability, and disclose the amount of measurement uncertainty around the estimate in the Measurement Uncertainty note.***

Tax appeals encompass a wide variety of specific issues related to various sections of many tax acts. It is not possible to determine whether there is a sufficient probability that an appeal will be successful and therefore should be recorded as a contingent liability. In the absence of sufficient and appropriate evidence to determine a probable amount of contingent liability resulting from tax appeals, GAAP recommends disclosure of the existence of potential contingent liabilities, which is included in note 25 (b) on page 72 of the 2010/11 Public Accounts.

Disclosure of changes in budgets

RECOMMENDATION: ***When government's planned estimates are not prepared on a basis consistent with that used to report the actual results, the planned results be restated. As well, reconciliation should be provided that shows the amendments made from the original Estimates to the amounts reported in the Summary Financial Statements.***

Government's estimates are authorized by legislation and the comparison of estimates to actual results are an important accountability measure for government. It would not be appropriate to adjust the estimates amount to match the actual results. Estimates should be adjusted only for those changes authorized by order in council to ensure transparency.

The Auditor General's report identifies restatements to the prior year comparative amounts in the 2011/12 Estimates which were authorized on May 3, 2011, after the reporting date of March 31, 2011. These changes affect only the comparative amounts in the 2011/12 Estimates and no change was made to the authority provided by the 2010/11 Estimates.

In the absence of a formal regulatory change to the 2010/11 Estimates it was not appropriate to adjust the Estimate amounts included in the 2010/11 Public Accounts.

Transparency and utility of contractual obligation disclosures

RECOMMENDATION: ***Government provide more complete disclosure of the anticipated payments to be made after five years so that stakeholders can fully appreciate the duration and timing of these obligations.***

RECOMMENDATION: ***Government expand its existing supplemental contractual obligation disclosures to ensure that stakeholders have access to information they might find significant. Disclosures should include:***

a) Significant terms and conditions of the contracts that could impact expected future cash inflows or outflows and service delivery continuance, key renewal and termination options, and any other rights or obligations that could have a material impact on the contract or on users of that contracted service;

b) More complete descriptions of the rules used to compile the supplementary contractual obligation disclosure, as well as any significant limitations these rules could impose on the use of the information; and

c) Comparative contractual obligation information to help readers understand trends in government's contractual obligations.

RECOMMENDATION: ***Government provide the supplemental contractual obligation disclosure information to the public in a format that is easy to use and that facilitates further stakeholder analysis and evaluation of results.***

We currently fulfill the requirements of GAAP in disclosing contractual obligations in our financial statements and have provided additional detailed disclosure as supplemental information to the Public Accounts. 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. These recommendations could be better addressed through governments "open data" strategy where an appropriate evaluation of the cost and benefits could be made as part of that broader strategy, unconstrained by the specific requirements and objectives of general purpose financial statements.

We believe the 2010/11 Public Accounts once again demonstrate 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.

Stuart Newton
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, 2007/08, 2008/09 and 2009/10 Public Accounts, we made a total of 54 recommendations, of which 14 were recommendations made in more than one year.

Of the 40 different recommendations: 12 have been completed or substantially completed; five have been partially completed; and six 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). This leaves the 17 outstanding recommendations that are listed below. As noted, some of these outstanding recommendations are made again in this year's report.

Report Year	*Auditor General Recommendations Not Yet Completed*	*Comment*
Government's financial statement discussion and analysis		
2006/07	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 five years. Government does not cross-reference between the Financial and Economic Review and its FSD&A in the Public Accounts. This year we also noted that there is no discussion of why the actual deficit was $1.4 billion less than the budget.
2006/07	We continue to recommend that government 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 2010/11 FSD&A.
2006/07	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 (FSD&A).	Not resolved. Government continues to use total revenue in its calculation of this vulnerability measure.
Disclosure of contractual obligations		
2006/07, 2007/08, 2008/09 and 2009/10	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, 2008/09 and 2009/10	We recommend that government use a lower cut-off for collecting and assessing the disclosure of contractual obligations in the Summary Financial Statements.	Not resolved. No change in 2011.

Report Year	Auditor General Recommendations Not Yet Completed	Comment
Disclosure of tangible capital assets under lease		
2006/07 and 2007/08	We continue to recommend that capital lease related liabilities be disclosed separately to meet Canadian generally accepted accounting principles (GAAP) for leased tangible capital assets.	Mostly resolved in 2010. The disclosure has been improved, but there is room for more improvement by disclosing particulars of significant leases. The PHH vehicle lease is not the most significant lease. No change in 2011.
Disclosure of material errors		
2006/07	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. No change in 2011.
Complete disclosure of prior year adjustments		
2008/09 and 2009/10	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. No change in 2011. There is no disclosure, for example, of the restatement of cash and investments by $79 million.
Oil and natural gas producers' royalty credits		
2007/08	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 the audit opinion reservations removed in this year's report.
Provision for deep-well credits		
2007/08	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 generally accepted accounting principles (GAAP).	Not resolved. See discussion of the audit opinion reservations removed in this year's report.
Accounting for, and recognition of, inherited Crown land revaluations		
2007/08, 2008/09 and 2009/10	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. No change in 2011. No significant issues this year.

Report Year	*Auditor General Recommendations Not Yet Completed*	*Comment*
Accounting for First Nations settlement costs		
2008/09 and 2009/10	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 generally accepted accounting principles (GAAP).	Not resolved. No change in 2011. No significant issues this year.
Classification of debt		
2008/09 and 2009/10	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.	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	We recommend that government present its statement of cash flow using the direct method.	Not resolved. No change in 2011.
Authority to borrow		
2008/09	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.	Not resolved. No change in 2011. 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	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.	Not resolved. In 2009, government had said it would continue to improve the alignment between the Estimates and the Summary Financial Statements as they address the recommendations of the Budget Process Review Panel. There were no changes in 2010 or 2011.
Ministry financial statements		
2008/09 and 2009/10	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 for which they are responsible.	Not resolved. No change in 2011.
Pension plan disclosure		
2009/10	We recommend that government improve its disclosure of pension plans as required by Canadian generally accepted accounting principles (GAAP).	Not resolved. No change in 2011.

APPENDIX C

MINISTRIES AND GOVERNMENT ORGANIZATIONS INCLUDED IN THE 2010/11 SUMMARY FINANCIAL STATEMENTS, AND THEIR AUDITORS

Sector and Organization[1]	Audited by: Auditor General	Audited by: Private Sector Auditors[2]
Consolidated Revenue Fund		
Eight Legislative Offices	✓	
Legislative Assembly	✓	
Office of the Premier	✓	
Ministry of Aboriginal Relations and Reconciliation	✓	
Ministry of Advanced Education	✓	
Ministry of Agriculture	✓	
Ministry of Attorney General	✓	
Ministry of Children and Family Development	✓	
Ministry of Community, Sport, and Cultural Development	✓	
Ministry of Education	✓	
Ministry of Energy and Mines and Responsible for Housing	✓	
Ministry of Environment	✓	
Ministry of Finance	✓	
Ministry of Forests, Lands and Natural Resource Operations	✓	
Ministry of Health	✓	
Ministry of Jobs, Tourism and Innovation	✓	
Ministry of Labour, Citizens' Services and Open Government	✓	
Ministry of Public Safety and Solicitor General	✓	
Ministry of Social Development and Responsible for Multiculturalism	✓	
Ministry of Transportation and Infrastructure	✓	
Health Sector		
BC Academic Health Council		✓

1 The organizations listed may also include one or more subsidiaries. Not all of these subsidiary organizations are separately listed.
2 Auditor General staff attend the Audit Committee meetings of a number of government organizations that are audited by private sector auditors.

Sector and Organization[1]	Audited by: Auditor General	Audited by: Private Sector Auditors[2]
Health Sector		
BC Health Services Purchasing Organization		✓
Bella Coola General Hospital		✓
Canadian Blood Services (government partnership)		✓
Fraser Health Authority		✓
Interior Health Authority		✓
Louis Brier Home and Hospital		✓
Menno Hospital		✓
Mount St. Mary Hospital		✓
Nisga'a Valley Health Authority		✓
Northern Health Authority		✓
Providence Health Care		✓
Provincial Health Services Authority		✓
R.W. Large Memorial Hospital		✓
St. Joseph's General Hospital		✓
St. Michael's Centre		✓
Vancouver Coastal Health Authority		✓
Vancouver Island Health Authority	✓	
Wrinch Memorial Hospital		✓
Education Sector		
British Columbia Institute of Technology		✓
Camosun College	✓	
Capilano University		✓
College of New Caledonia		✓
College of the Rockies		✓
Douglas College	✓	

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2 Auditor General staff attend the Audit Committee meetings of a number of government organizations that are audited by private sector auditors.

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Sector and Organization[1]	Audited by: Auditor General	Audited by: Private Sector Auditors[2]
Education Sector		
Emily Carr University of Art and Design		✓
Industry Training Authority	✓	
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		✓
Private Career Training Institutions Agency		✓
Royal Roads University		✓
School District No. 5 (South East Kootenay)		✓
School District No. 6 (Rocky Mountain)		✓
School District No. 8 (Kootenay Lake)		✓
School District No. 10 (Arrow Lakes)		✓
School District No. 19 (Revelstoke)		✓
School District No. 20 (Kootenay-Columbia)		✓
School District No. 22 (Vernon)		✓
School District No. 23 (Central Okanagan)		✓
School District No. 27 (Cariboo-Chilcotin)		✓
School District No. 28 (Quesnel)		✓
School District No. 33 (Chilliwack)		✓

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2 Auditor General staff attend the Audit Committee meetings of a number of government organizations that are audited by private sector auditors.

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Sector and Organization[1]	Audited by: Auditor General	Audited by: Private Sector Auditors[2]
Education Sector		
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)		✓
School District No. 47 (Powell River)		✓
School District No. 48 (Sea to Sky)		✓
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)		✓

1 The organizations listed may also include one or more subsidiaries. Not all of these subsidiary organizations are separately listed.
2 Auditor General staff attend the Audit Committee meetings of a number of government organizations that are audited by private sector auditors.

Sector and Organization[1]	Audited by: Auditor General	Audited by: Private Sector Auditors[2]
Education Sector		
School District No. 61 (Greater Victoria)	✓	
School District No. 62 (Sooke)		✓
School District No. 63 (Saanich)		✓
School District No. 64 (Gulf Islands)		✓
School District No. 67 (Okanagan-Skaha)		✓
School District No.68 (Nanaimo-Ladysmith)		✓
School District No. 69 (Qualicum)		✓
School District No. 70 (Alberni)		✓
School District No. 71 (Comox Valley)		✓
School District No. 72 (Campbell River)		✓
School District No. 73 (Kamloops-Thompson)		✓
School District No. 74 (Gold Trail)		✓
School District No. 75 (Mission)		✓
School District No. 78 (Fraser-Cascade)		✓
School District No. 79 (Cowichan Valley)		✓
School District No. 81 (Fort Nelson)		✓
School District No. 82 (Coast Mountains)		✓
School District No. 83 (North Okanagan-Shuswap)	✓	
School District No. 84 (Vancouver Island West)		✓
School District No. 85 (Vancouver Island North)		✓
School District No. 87 (Stikine)		✓
School District No. 91 (Nechako Lakes)		✓
School District No. 92 (Nisga'a)		✓
School District No. 93 (Conseil Scolaire Francophone)		✓
School District consolidation [3]	✓	

1 The organizations listed may also include one or more subsidiaries. Not all of these subsidiary organizations are separately listed.
2 Auditor General staff attend the Audit Committee meetings of a number of government organizations that are audited by private sector auditors.
3 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).

APPENDIX C

Sector and Organization[1]	Audited by: Auditor General	Private Sector Auditors[2]
Education Sector		
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		✓
Natural Resources and Economic Development Sector		
BCIF Management Ltd [4]	✓	
BC Immigrant Investment Fund Ltd	✓	
BC Pavilion Corporation	✓	
British Columbia Enterprise Corporation	✓	
British Columbia Hydro and Power Authority [4]		✓
British Columbia Innovation Council		✓
Columbia Basin Trust		✓
Columbia Power Corporation [4]	✓	
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		✓

1 The organizations listed may also include one or more subsidiaries. Not all of these subsidiary organizations are separately listed.
2 Auditor General staff attend the Audit Committee meetings of a number of government organizations that are audited by private sector auditors.
4 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.

APPENDIX C

Sector and Organization[1]	Audited by: Auditor General	Audited by: Private Sector Auditors[2]
Transportation Sector		
BC Transportation Financing Authority	✓	
British Columbia Railway Company [4]	✓	
British Columbia Transit	✓	
Rapid Transit Project 2000 Ltd		✓
Transportation Investment Corporation [4,5]	✓	
Social Services Sector		
Community Living British Columbia	✓	
Legal Services Society		✓
Other Sector		
BC Games Society		✓
British Columbia Assessment Authority	✓	
British Columbia Housing Management Commission		✓
British Columbia Public School Employers' Association		✓
Community Social Services Employers' Association		✓
First Peoples' Heritage, Language and Culture Council		✓
Health Employers Association of British Columbia		✓
Post-Secondary Employers' Association		✓
Provincial Capital Commission[4]		✓
Provincial Rental Housing Corporation		✓
The Royal British Columbia Museum Corporation		✓
Protection of Persons and Property Sector		
British Columbia Securities Commission	✓	

1 The organizations listed may also include one or more subsidiaries. Not all of these subsidiary organizations are separately listed.
2 Auditor General staff attend the Audit Committee meetings of a number of government organizations that are audited by private sector auditors.
4 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.
5 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.

Sector and Organization[1]	Audited by: Auditor General	Audited by: Private Sector Auditors[2]
Protection of Persons and Property Sector		
Insurance Corporation of British Columbia[4]		✓
Organized Crime Agency of British Columbia Society		✓
General Government Sector		
British Columbia Liquor Distribution Branch[4]	✓	
British Columbia Lottery Corporation[4]		✓

1 The organizations listed may also include one or more subsidiaries. Not all of these subsidiary organizations are separately listed.
2 Auditor General staff attend the Audit Committee meetings of a number of government organizations that are audited by private sector auditors.
4 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.

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 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. CAS results from the adoption of International Standards on Auditing (ISA), developed and issued by the International Auditing and Assurance Standards Board (IAASB). These standards are to be followed by every audit practitioner (including the Auditor General) who issues an audit opinion on a set of financial statements in Canada.

Canadian Institute of Chartered Accountants (CICA)

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

CICA Accounting Handbook

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

Exchange and non-exchange transactions

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

Financial Accounting 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 CICA and the 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 CICA to be followed by every audit practitioner (including the Auditor General) who issues an audit opinion on a set of financial statements. See *Canadian Auditing Standards*.

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 not-for-profit organization

A government organization normally without transferable ownership interest that is 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 that are controlled, as defined by public sector accounting standards, by the government and included in the government reporting entity.

Government partnership

A contractual arrangement between the government and a party or parties outside the government reporting entity where the partners cooperate toward achieving significant clearly defined common goals, make a financial investment in the government partnership, share control of the decisions related to the financial and operating 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 (IASB), to be followed in the preparation and presentation of financial statements by government business enterprises or other government organizations. Canada implemented IFRS starting on 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, given the circumstances, it is probable that the decision of a person who is relying on the financial statements, and who has a reasonable knowledge of business and economic activities, will be changed or influenced by the misstatement.

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 subsidiary are recorded in the financial statements of the parent organization. Accounting policies of the subsidiary are not conformed to those of the parent. This method is used to consolidate government business enterprises.

Modified opinion

A qualified opinion, an adverse opinion or a disclaimer of opinion.

Non-exchange transaction

See *exchange and non-exchange transactions.*

Other Government Organization (OGO)

A government organization that does not meet the definition of a government, a government business enterprise or a government not-for-profit.

Public Sector Accounting Board (PSAB)

A board that 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).

Qualified (audit) opinion

When an auditor issues a "qualified opinion" they are communicating that they have concerns, or reservations, with the entity's compliance with accounting standards (GAAP) or with their ability to gather sufficient and appropriate audit evidence.

Tangible capital assets

Non-financial assets having physical substance that:

(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.