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OFFICE OF THE
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AUDIT OPINIONS ARE IMPORTANT

A discussion on the qualified audit opinion on B.C.'s 2011/12 Summary Financial Statements

AUDITOR GENERAL'S COMMENTS

Under section 11 (1) of the *Auditor General Act,* I am required to report on whether the Province's financial statements are presented fairly in accordance with generally accepted accounting principles (GAAP).

My auditor's report on the Province's fiscal 2011/12 Summary Financial Statements contains four qualifications. Two of these qualifications have recurred several times over the last few years. The qualifications related to the inappropriate deferral of government transfers revenue, and failure to disclose required GBE financial information are new this year. The issuance of a qualified auditor's report is a rare occurrence and, ideally there should be no qualifications.

Over the last several years, I have issued qualified audit reports – or reports with 'reservations' – on the Province's Consolidated Summary Financial Statements stating that they were not in accordance with Canadian GAAP. Last year's reservation included in the audit report was the same as one of the reservations I noted in prior years, because government chose not to adjust its statements to conform to GAAP.

During the audit of the 2011/12 Summary Financial Statements, I recommended 93 corrections be made to be in accordance with GAAP; government chose to correct 35 of those items. Of the remaining 58 items, only four were 'material' or significant enough to include as reservations in my audit report.

Previous to my term as Auditor General, it took government eight years to adjust for the reservation around not including schools, universities, colleges and hospitals in its summary financial statements. I trust that it will not take as long to address the reservations in last year's financial statements, as they are all easily corrected.

In the auditing profession, in both the private and public sectors, a qualified audit report is a rare occurrence. It indicates to the users of the financial statements that some of the information is not auditable or could be misleading. During the last 17 years, this Office has issued qualified audit reports on the Province's financial statements 13 times. For a government that strives for transparency and accountability, this is unacceptable.

In August 2012, I will submit a report to the Legislative Assembly that discusses these reservations in detail, along with government's response. However, I am producing this information bulletin to clearly explain the significance of issuing a qualified audit report.

John Doyle, MAcc, CA
Auditor General
July, 2012

INTRODUCTION

On April 1, 2004, British Columbia became a leader among governments in Canada when it implemented legislation requiring that the Province's Summary Financial Statements be prepared in accordance with generally accepted accounting principles (GAAP),[1] the industry standard. As such, any departure from Canadian GAAP, whether material (significant) or not, puts the government in the position of being in non-compliance with legislation.

Issued by the Public Sector Accounting Board, an independent body, GAAP includes standards that accountants use in the preparation of financial statements. GAAP give users of financial statements the most consistent basis of reporting and information for forming decisions: accountants use GAAP to prepare their financial statements, while auditors use GAAP to assess whether the standards have been met in that process and to form opinions on the fairness of financial presentation. Without GAAP as a basis for preparing and auditing financial statements, it would be difficult to compare the results of one entity with another, and the transparency and accountability of management would have been difficult to measure.

The application of GAAP in preparing financial statements varies among Canadian jurisdictions because of differences in legislation, regulations and reporting entity make-up. So, although some transactions look similar from one jurisdiction to the next, how they are recorded and presented in financial statements may differ depending on the particular facts of the situation.

The Province of British Columbia requires an audit of its Summary Financial Statements through section 11 of the Auditor General Act. This Act requires that the Auditor General report on whether the Province's financial statements are presented fairly in accordance with GAAP.

In government's 2011/12 Summary Financial Statements, we found areas that did not comply with GAAP: four of these were material. In fact, in 13 of the last 17 years, British Columbia's Auditors General have had concerns about the financial statements and have issued qualified audit opinions - a statement as to the quality of the financial statements that points out areas of concern regarding compliance with GAAP or a lack of evidence to support what is recorded in the financial statements.

We have produced this information bulletin to explain the significance of this issue. The appendices at the end of this bulletin provide additional details on the qualifications.

Definitions

GAAP:
Generally Accepted Accounting Principles (the industry standard)

Material:
something of significance to users of the financial statements

Opinion:
the auditor's statement (or opinion) as to the quality of the financial statements. It should be a "clean opinion" with no reservations

Reservation:
if certain parts of the financial statements do not follow GAAP or if not enough information is available to make a decision, the auditor may include a reservation in their audit opinion to discuss the situation

Disclosure:
notes made in the financial statements to explain certain numbers or accounting policies

WHY DO WE ISSUE AUDIT REPORTS?

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 reader's attention any concerns auditors have with the quality of the financial statements.

Many people assume 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 those without such a report.

When auditors issue a 'qualified report' (a rare occurence), they are communicating that they have concerns or reservations with:

- their ability to gather sufficient and appropriate information; or
- the entity's compliance with accounting standards (GAAP).

In the case of British Columbia's Summary Financial Statements, the Auditor General qualified his report this year because the Province did not materially (significantly) comply with GAAP.

During that audit, we identified 93 account balance and disclosure (notes to explain parts of the financial statements) adjustments to be made, of which government chose to adjust only 35 items. Of the remaining 58, four were material or significant enough to be included as reservations in the audit report.

1 See the Budget Transparency and Accountability Act, section 23.1.

In determining whether a reservation is necessary, an auditor considers the materiality or significance of the misstated items individually and collectively, in relation to the financial statements as a whole. A reservation would not be made for an immaterial misstatement or something deemed insignificant.

An auditor is required to use professional judgment to determine materiality based on his, or her, perception of the users' needs. To aid the auditor, a numerical threshold for materiality is set. For example, materiality could be set at half a per cent of expenses. Typically, if the misstatements found by the auditor are less than materiality (or less than half a per cent of expenses as per the example), individually or collectively, then no adjustment is 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.

The auditor must also take into consideration qualitative factors. For example, it is possible for a relatively small amount to have a material effect on the financial statements when the amount changes a deficit into a surplus (or vice versa), alters a trend or changes a key ratio. As well, disclosure that is not complete or that provides inappropriate information may be considered to have a material effect. For this reason, an auditor may express a reservation on a lack of disclosure even though that missing disclosure does not impact the reported balances in the financial statements.

The reservations noted in the Auditor General's 2011/12 audit report on the Province's Summary Financial Statements were for items that departed from GAAP in a way that exceeded the materiality threshold. We reported those items because they impact the fairness of the presentation of areas within the financial statements.

WHY DO RESERVATIONS MATTER?

A reservation is a concern that an auditor has regarding the fairness of how something is reported in a set of financial statements. An audit report with reservations can impact the operations of an entity by lowering the entity's credit rating or its share prices, or increasing the interest rates charged by its lenders, thus increasing the cost of raising money.[2]

Public corporations (entities traded on a securities exchange) are required to have unqualified audit reports annually. In British Columbia, should a public corporation be given an audit opinion with a reservation, the British Columbia Securities Commission could 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.

Although 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 that audit reservations on public corporations' financial statements are extremely rare because of the potentially severe consequences.

While governments are not subject to public corporation reporting requirements, a qualified audit report could impact their credit rating or cost of debt. 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".[3] This does not appear to be the case in British Columbia, where the accountability for not complying with GAAP appears to have had little impact on government.

2 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.
3 Canadian Institute of Chartered Accountants, Public Sector Accounting Handbook, section 1100, appendix A, point 9.

THE 2011/12 RESERVATIONS

The GAAP departures resulting in reservations for the 2011/12 British Columbia Summary Financial Statements are explained in both the Auditor General's audit opinion and our *Observations on Financial Reporting: Summary Financial Statements 2011/12* report. A discussion of why the reservations were necessary follows.

The four reservations found on the Province's 2011/12 Summary Financial Statements were:

- failure to properly consolidate the Transportation Investment Corporation;
- failure to provide for earned natural gas producer royalty credits;
- inappropriate deferral of government transfers revenue; and
- failure to disclose required government business enterprise (GBE) financial information.

We discuss each of these separately below.

Failure to properly consolidate the Transportation Investment Corporation

Our first reservation on the 2011/12 Summary Financial Statements concerns how the Province is consolidating a specific and significant entity, the Transportation Investment Corporation (TIC).

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: the Summary Financial Statements.

In public sector consolidations, the method of consolidating different entities depends on what type of organization an entity is classified as. Public sector GAAP standards have specific criteria for classifying organizations. For the purposes of 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 (to avoid double counting) 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 GAAP criteria of 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. as its principal activity, sells goods and services to individuals and organizations outside of the government reporting entity; and
2. in the normal course of its operations, maintains its operations and meets its liabilities from revenues received from sources outside of the government reporting entity.[4]

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 currently 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 currently has is the interest income being earned on the funds provided by government debt and that is offset against construction costs.

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

The financial model developed by the TIC forecasts that it will not be profitable until 2017/18. In our analysis of the model, we identified a number of areas where further clarification is needed. As well, many variables could impact the future revenue estimates in the financial model and, therefore, the date that the TIC actually becomes profitable. The revised model has not yet been provided to the Auditor General as of July 2012.

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

The main impacts of TIC on the March 31, 2012 Summary Financial Statements are as follows:

Consolidated statement of financial position(balance sheet):	Increase/(decrease) in $ millions
Loans for purchase of assets, recoverable from agencies	(1,779)
Accounts payable and accrued liabilities	519
Taxpayer-supported debt	1,779
Self-supported debt	(1,779)
Tangible capital assets	2,331
Consolidated statement of operations(income statement):	
Surplus (deficit) for the year	(97)

The increase to the deficit for the year relates to realized losses on interest rate hedging transactions that would be recorded as an expense if the TIC was fully consolidated. Other line items in the summary financial statements were also impacted by lesser amounts.

The presentation of contractual obligations in note 26 (c) in the summary financial statements would also differ. Contractual obligations for taxpayer-supported Crown corporations (transportation) would have increased by $661 million (2011: $1,114 million), and contractual obligations for self–supported Crown corporations (transportation) would have decreased by $661 million (2011: $1,114 million).

Failure to provide for earned natural gas producer royalty credits

Our second qualification pertained to the government's failure to set up a provision or liability for the deep-well credits given to natural gas producers. These credits are used to reduce the amount of royalties that the natural gas producers must pay to the Province when they extract natural 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.

Deep-well credits are actually an expense incurred by the government to promote the development of British Columbia's natural gas resources, and should be recorded as a liability. For the credits to be recorded as a liability and be in accordance with public sector GAAP, they must have three essential characteristics:

- They must embody a duty or responsibility to others, leaving a government little, or no, discretion to avoid settlement of the obligation.
- The duty or responsibility to others must entail settlement by future transfer or use of assets, provision of goods or services or other forms of economic settlement at a specified or determinable date, on occurrence of a specified event, or on demand.
- The transactions or events obligating government must have occurred already.[5]

The first characteristic is met, as a government regulation establishes the right to the credit. Thus, after the well is drilled, there is little discretion for government to avoid settlement when natural gas is extracted from it. The second characteristic is met, because the credit is used against the royalty payment the producer must make for extraction of the natural gas. This is the 'specified' event that requires the 'economic settlement' of the liability. And, the third characteristic is met as soon as the company drills a well to the required depth.

Air Miles© rewards given out by airlines represent a similar situation. Airlines give Air Miles to individuals who have made a past purchase to earn the reward. The Air Miles may be used only in future transactions, the timing of which is unknown. As soon as a purchase has been made that qualifies for Air Miles, the airline owes the Air Miles to that individual and this is acknowledged by providing the individual a statement showing the Air Miles earned. In other words, the liability, or amount owing, should be recorded by the airline when the Air Miles are earned.

The timing of when natural gas production begins may vary; however, based on historical trends, government has enough information to provide a reasonable estimate on how many credits will be used, and how many are incurred during the year. Government calculates a credit based on information received from the producers. Each well's credit bank is shown on the invoices sent to the producers, as is the adjustment made to royalty revenue. The total amount that should be recorded as a liability in the Summary Financial Statements is easily determinable.

The financial impact on the statements of not recording deep-well credits is as follows:

- Natural resource and economic development expenses are understated by $702 million.
- Accounts payable and accrued liabilities are understated by $702 million.
- Deficit is understated by $702 million.

5 Liability characteristics defined by GAAP are described in the *CICA Public Sector Handbook* section 1000.45.

Inappropriate deferral of government transfers revenue

The third qualification concerned the inappropriate deferral of transfers received from the federal government and other outside entities.

Government's accounting treatment for funds received from the Federal Government and other outside entities restricted for the purchase or construction of capital assets is to defer such transfers and recognize as revenue in the statement of operations on the same basis as the related assets are amortized. This is not in accordance with Canadian public sector accounting standards, which require transfers of a capital nature to be recorded in revenue when the funds provided have been used to purchase or construct the capital asset, or, if there are stipulations imposed by the transferring entity which give rise to an obligation, when the obligation is settled.

This financial impact on the statements of deferring these transfers is as follows:

- deferred revenues are overstated by $279 million
- contributions from the federal government are understated by $200 million
- miscellaneous revenues are understated by $79 million
- deficit is overstated by $279 million

Failure to disclose required government business enterprise financial information

Organizations that meet the definition of a government business enterprise are consolidated using the modified equity method of accounting. This means that only the investment in the organization is recorded, adjusted for its earnings, less any amounts paid as dividends. (Our first reservation this year, concerning the failure to properly consolidate the Transportation Investment Corporation, concerns its classification as a government business enterprise.) When an organization is accounted for in this way, Canadian public sector accounting standards require that condensed supplementary financial information be provided in the notes about its financial position and results of operations, so readers can appreciate the scope of such operations.

However, Government is not disclosing this condensed supplementary financial information about the financial position and results of operations of certain subsidiaries of government organizations that are accounted for as government business enterprises.

Had this information been disclosed, the supporting statements for self-supported Crown corporations and agencies on pages 94 and 95 would have been different as follows:

- assets would have been greater by $1,122 million;
- liabilities other than debt would have been greater by $207 million;
- other debt would have been greater by $655 million;
- equity would have been greater by $260 million;
- revenues would have been greater by $230 million;
- expenses would have been greater by $148 million; and
- net earnings would have been greater by $82 million.

There would also have been changes to some amounts in the condensed supplementary financial information reconciling net earnings of self-supported Crown corporations and agencies to equity in self-supported Crown corporations and agencies for the year would have also changed.

In addition, all of the investments in these subsidiaries should have been reported as investments in government business enterprises. Had this been done, equity in self-supported crown corporations and agencies, as reported on the consolidated statement of financial position, would have been greater by $241 million, and other investments would have been less by $241 million.

However, the deficit for the year as reported in the consolidated statement of operations would not have been impacted.

Overall impact of the qualifications on the recorded deficit for the year

If the summary financial statements were prepared fully in accordance with Canadian public sector accounting standards, the recorded deficit for the year would have been $520 million higher. The actual deficit for the year would therefore have been $2,360 million

OTHER MATTERS

Public sector accounting standards are currently in a state of transition in Canada. Many government entities have, or will be in 2012/2013, moving to new accounting frameworks.

The government business enterprises with the exception of BC Hydro moved to International Financial Reporting Standards in 2011/2012. BC Hydro will be moving to International Financial Reporting Standards, with the addition of part of the US standard on rate regulated reporting in 2012/2013.

Crown corporations and agencies moved to Public Sector Accounting Standards in 2011/2012.

Schools, Universities, Colleges, Health Authorities and Hospital Societies will be moving to Public Sector Accounting Standards in 2012/2013.

COMMENTS

The Auditor General welcomes your feedback and/or questions on this information bulletin, as well as your suggestions for potential audits.

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APPENDIX A – FAILURE TO PROPERLY CONSOLIDATE THE TRANSPORTATION INVESTMENT CORPORATION

Statement of Problem

Government has classified the Transportation Investment Corporation (TIC) as a government business enterprise and therefore is consolidating the TIC into the Summary Financial Statements using the modified equity method of accounting. In our opinion, the TIC does not meet the criteria to be classified as a government business enterprise and therefore should be consolidated on a line-by-line basis. This means the accounting is not in accordance with public sector accounting standards (that is, GAAP).

Background

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

The service that government will sell to the public is the use of the Port Mann Bridge. However, the bridge is not expected to be ready for use or begin collecting tolls until 2012/13. Government's projections suggest the TIC will not achieve a profitable status until 2017/18.

Analysis

Public Sector Accounting Handbook, section 1300, "Government Reporting Entity," contains the accounting guidance for determining how the TIC should be classified and therefore how it should be consolidated in the Summary Financial Statements.

Per PS1300.28: A government business enterprise is an organization that has all of the following characteristics:

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

This definition requires that an entity have all four characteristics to meet the definition of a government business enterprise. Therefore if any one of the criteria is not met, the TIC cannot be classified as a government business enterprise. We agree that the TIC meets the characteristics for items (a) and (b). We disagree that the TIC meets the characteristics of items (c) and (d). Therefore, it cannot be classified as a government business enterprise and be in accordance with GAAP.

PS1300.28(c) requires an entity to be selling goods or services to individuals and organizations outside of the government reporting entity as its principal activity. The current principal activity of the TIC is constructing the new Port Mann Bridge. As the bridge is still under construction and not in operations, i.e. not collecting toll revenues, the TIC is not selling goods or services and therefore does not meet the criteria set out in PS1300.28(c).

PS1300.28 (d) requires an entity to maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity in the normal course of its operations.

As previously mentioned, the TIC's current principal activity is constructing a bridge. It does not have any revenues from sources outside of the government reporting entity. The government currently supports the use of toll revenues to finance, operate and maintain the bridge. However, since the bridge is not yet in service, it has not yet begun to collect any revenue from outside the reporting entity. As noted above, tolls will not begin to be collected until fiscal 2012/13 when construction is substantially complete.

Government "invested" in the TIC with an upfront payment of $100 million. As well, the TIC has borrowed money from the Government each year, and now owes just over $1.8 billion. Therefore, the TIC does generate some investment income from the funds it holds, but these funds are not sufficient to maintain the TIC's operations or meet its liabilities and they do not qualify as a good or service that is sold. The TIC's financial statements show a net loss from operations of $16.7 million in fiscal 2011/12, and cumulative losses from operations to date of $75 million.

For these reasons, the TIC does not meet the criteria set out in PS1300.28 (d).

The Summary Financial Statements were prepared this year using Canadian public sector accounting standards. When an entity is fully consolidated, its results are adjusted for any differences between those standards and the accounting framework the entity has used to prepare its financial statements. The TIC is using International Financial Reporting Standards as its accounting framework. In determining the impact of not consolidating the TIC, we needed to determine what adjustments, if any, needed to be made to the TIC's results so that they were in accordance with Canadian public sector accounting standards. A significant difference that needed to be adjusted was the treatment of realized gains and losses on interest rate hedges. The hedging losses that the TIC has incurred are allowed to be amortized over the term of the debt under International Financial Reporting Standards, but under Canadian public sector accounting standards the losses must be recognised in full in the same period that they are realized. (The only hedging gains and losses that Canadian public sector accounting standards allow to be accounted for using "hedge accounting" are those related to foreign exchange.) As a result, the impact of fully consolidating the TIC is to record an additional loss of $97 million.

Conclusion

The Transportation Investment Corporation does not meet the definition of a government business enterprise and therefore should be fully consolidated in the Summary Financial Statements. Our Office will continue to review the status of the TIC each year to determine if it meets the definition of a government business enterprise and can therefore be consolidated on the modified equity method.

APPENDIX B – FAILURE TO PROVIDE FOR EARNED NATURAL GAS PRODUCER ROYALTY CREDITS

Statement of Problem

Unused deep-well credits earned by natural gas producers have not been recorded as a liability by the Province in the Summary Financial Statements. This means the accounting is not in accordance with public sector accounting standards (that is, GAAP).

Background

Government provides deep-well credits as an incentive to industry to drill wells that would be otherwise uneconomical to drill. As at March 31, 2012, there was $702 million of unused deep-well credits earned by natural gas producers for the past drilling of wells that qualify as deep wells. These credits have not yet been applied against royalty revenue (which would reduce the amount of royalties payable) and remain in the government's "deep-well bank" for deep-well credits earned but not yet used.

Each month when there is production from a deep well, the government calculates the amount of royalties' payable on that production. Then, any credits in the deep-well bank applicable to a specific well are used to reduce the amount payable, which can reduce the payment to nil if there are enough credits available for that well. Any remaining credit balance is carried forward for use in future months. Therefore, the credit in the deep-well bank as at year-end is due to insufficient production from the applicable wells and hence insufficient royalties payable at that time to have used all the credits.

Analysis

Public Sector Accounting Handbook, section 1000, "Financial Statement Concepts," contains the accounting guidance for when a liability should be recognized in the Summary Financial Statements.

Per PS1000.44: Liabilities are present obligations of a government to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits.

Per PS1000.45: Liabilities have three essential characteristics:

a) they embody a duty or responsibility to others, leaving a government little or no discretion to avoid settlement of the obligation;
b) the duty or responsibility to others entails settlement by future transfer or use of assets, provision of goods or services, or other form of economic settlement at a specified or determinable date, on occurrence of a specified event, or on demand; and
c) the transactions or events obligating the government have already occurred.

PS1000.45 (a) requires that there be little or no discretion to avoid settlement of the obligation. This characteristic is met as the government is obligated to allow the entity to use the credits awarded to it whenever royalties are payable on that well's production.

PS1000.45 (b) has several options that may be applied to satisfy the characteristic. The option of future economic settlement on occurrence of a specified event is met because the credits awarded to the entity are used as a reduction of royalties' payable on the future production of that well.

PS1000.45(c) requires the event obligating the government to have already occurred. This characteristic is met because the credits are awarded only once an entity has completed the drilling of a deep well.

As the deep-well credits embody all three essential characteristics of a liability, they should be recorded as such in the Summary Financial Statements.

Conclusion

The $702 million of deep-well credits earned by oil and natural gas producers, but not yet used as at March 31, 2012, meet the definition of a liability and should be recognized in the Summary Financial Statements as of that date.

Since this issue has been raised by the Auditor General in prior years, Canadian public sector accounting standards[6] require that it be corrected prospectively.

6 PS 2120.31: An issue raised with a government by its auditor in one period but not corrected by the government until a subsequent period is not an error, for purposes of this Section; the issue would be accounted for in the period in which the correction is made.

APPENDIX C – INAPPROPRIATE DEFERRAL OF GOVERNMENT TRANSFERS REVENUE

Statement of problem

$279 million of funds received from the Federal Government and other outside entities restricted for the purchase or construction of capital assets has been deferred and is being recognized over the life of the asset. This funding should be recognized in revenue as the conditions for earning it are met.

Background

Canadian public sector accounting standards require that transfers received be recognized as revenue unless there are stipulations attached to the transfers that create a liability. If there are stipulations that create a liability, the transfers can be deferred and recognized as revenue as the liability is extinguished.

The Government's position is that transfers received for the construction of highway infrastructure assets have stipulations attached to them that require the government to hold on to the assets over their useful life.

Analysis

In our view, the stipulations attached to the transfers only require them to be used to construct the highway infrastructure, and to maintain it as a highway for public use for a specified period of time, which is less than the useful life of the highway. In addition, some of the transfers had no stipulations beyond construction of the assets. As a result, a portion of the transfers received that are being deferred and amortized over the life of the highway should be brought into revenue this year, as the asset has been built, or the specified period of time has elapsed, even though the useful life is not at an end.

The amount of the transfers that have been deferred that should have been brought into revenue is $279 million. As a result:

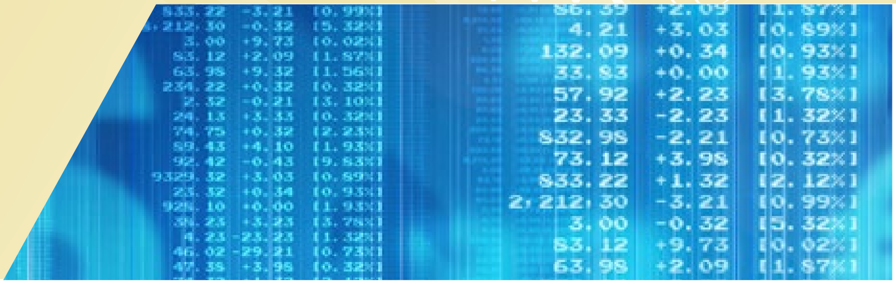
- deferred revenues are overstated by $279 million
- contributions from the federal government are understated by $200 million
- miscellaneous revenues are understated by $79 million
- deficit is overstated by $279 million

Conclusion

Transfers received should be brought into revenue unless there are stipulations that create a liability. If a liability has been created, revenue should be recognised as the liability is extinguished.

Since this issue has been raised by the Auditor General in prior years, Canadian public sector accounting standards[7] require that it be corrected prospectively.

7 PS 2120.31: An issue raised with a government by its auditor in one period but not corrected by the government until a subsequent period is not an error, for purposes of this Section; the issue would be accounted for in the period in which the correction is made.



APPENDIX D - FAILURE TO DISCLOSE REQUIRED GOVERNMENT BUSINESS ENTERPRISE FINANCIAL INFORMATION

Statement of problem

In fiscal year 2011/12, Government failed to disclose required supplementary information about the financial position and results of operations of certain subsidiaries of government organizations that are accounted for as government business enterprises.

Background

Government business enterprises are accounted for by the equity method, which means that only their aggregated net assets and changes in net assets are reported.

Users of financial statements need an appreciation of the magnitude of financial activities conducted by government business enterprises and the effect of their operations on the government reporting entity. As a result, Canadian public sector accounting standards require that condensed supplementary financial information be presented in the notes to the Summary Financial Statements, to provide users with an informative accounting of the full nature and extent of the financial affairs and resources of government business enterprises. As well, this shows a measure of the impact government business enterprises may have on a government's ability to discharge its liabilities or to provide financial resources for future operations.

Analysis

This supplementary financial information is disclosed for most of the government business enterprises, but not for the joint ventures of the Columbia Power Corporation and Columbia Basin Trust, and also the real estate investment subsidiaries of certain universities. These are considered to be business enterprises, and so are accounted for using the equity method. As a result, Government should have disclosed condensed supplementary financial information about their financial position and results of operations.

These figures are significant. Had this information been disclosed, the supporting statements for self-supported Crown corporations and agencies on pages 94 and 95 of the summary financial statements, would have been different as follows:

- assets would have been greater by $1,122 million;
- liabilities other than debt would have been greater by $207 million;
- other debt would have been greater by $655 million;
- equity would have been greater by $260 million;
- revenues would have been greater by $230 million;
- expense would have been greater by $148 million; and
- net earnings would have been greater by $82 million

In addition, all of the investments in these subsidiaries should have been reported as investments in government business enterprises. Had this been done, equity in self-supported crown corporations and agencies, as reported on the consolidated statement of financial position, would have been greater by $241 million, and other investments would have been less by $241 million.

However, the deficit for the year as reported in the consolidated statement of operations would not have changed.

Conclusion

The equity in self-supported Crown corporations and agencies reported in the Summary Financial Statements, and the supplementary statements that show the condensed financial information of those entities, should include all subsidiaries that are business enterprises and accounted for using the modified equity method.