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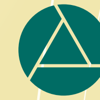

OFFICE OF THE
Auditor General
of British Columbia

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AUDIT OPINIONS ARE IMPORTANT

A discussion of the qualified audit opinion on B.C.'s 2012/13 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 Canadian generally accepted accounting principles (GAAP). My *auditor's report* is the culmination of the largest audit in British Columbia. It encompass over 150 government entities, including core government, Crown corporations, trusts, colleges, school districts, universities, health authorities and other public-sector entities. It takes nearly 70 staff in my Office over 45,000 hours to complete and requires assistance from about 30 private-sector auditing firms.

My report on the Province's 2012/13 Summary Financial Statements contains three qualifications or three areas of concern. A qualified auditor's report is a rare occurrence in both private- and public-sector accounting; ideally, there should be no qualifications.

One qualification is around the Transportation Investment Corporation, which is the company responsible for the Port Mann Bridge. This qualification has been in place for five years, although I anticipate removing it in the near future. The other two are related to how government defers funds it receives from sources such as the federal government, or private donors to, for example, a university.

If Government had adjusted these three areas using the new accounting standards and in the format they committed to adopting, it would have recorded a $1.7 billion surplus rather than a $1.1 billion deficit. Alternatively, if they had applied the new standards retroactively, the other format allowed, the deficit would have been reduced by an estimated $71 million to $1.075 billion.

While a surplus sounds favourable, it does not mean that government would have extra money. These funds are already allocated to their respective projects.

You might wonder why there is such a large difference in my calculations of Government's bottom line versus Government's. Much of it has to do with two new accounting standards that all Canadian governments had to adopt this past year. These standards require certain funds received from other governments and the private sector to be accounted for differently. The new standards are challenging to interpret and use, although the major private-sector accounting firms in B.C. agree with my interpretation of the standard.

Part of the challenge relates to government's need to "balance the budget" per its balanced-budget legislation and its legislated commitment to following public-sector accounting standards. While balancing the budget according to these new accounting standards is more difficult, it is not insurmountable.

This is explained more fully throughout this bulletin, and specifically, in the Common Questions and Answers section at the end.

As much more than these three qualifications arose from our audit of Government's Summary Financial Statements, I will release my annual *Report on the Public Accounts* in early fall. In the interim, this brief bulletin should explain and clarify the rationale for and the significance of these three qualifications.

Russ Jones, MBA, CA
Auditor General
August 2013

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INTRODUCTION

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

For the fiscal year starting April 1, 2004, British Columbia became a leader among governments in Canada, enacting legislation that requires that the Province's Summary Financial Statements be prepared in accordance with Canadian generally accepted accounting principles (GAAP). [1]

Under this legislation, any statements that depart from GAAP – whether material (significant) or not – puts the government in the position of being non-compliant with its own legislation.

GAAP includes standards and rules that accountants use in the preparation of financial statements and that auditors use to assess whether the standards have been met and to form an opinion on the fairness of the statements. All levels of government across Canada use a form of GAAP specifically designed for the public sector called Public Sector Accounting Standards (PSAS). These standards are issued by the Public Sector Accounting Board, an independent standard-setting body. How each jurisdiction applies GAAP can vary by differences in legislation, regulations, composition of the reporting entity, and interpretation of the accounting standards.

In the Province's 2012/13 Summary Financial Statements, we again found areas that did not comply with GAAP, and three of these were material.

WHY WE ISSUE AUDIT REPORTS

Audit reports represent an auditor's professional opinion on whether an entity's financial position and results of its operations are 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. These concerns are expressed as qualifications.

On the rare occasion that auditors issue a "qualified report," they are saying that they have concerns with:

- the availability of sufficient and appropriate information for users to make an informed decision; or
- the entity's compliance with accounting standards (GAAP).

In determining whether a qualification is necessary, an auditor considers the materiality of the misstated items, individually and collectively, in relation to the financial statements as a whole. As well, a numerical threshold for materiality is set. For example, materiality could be set at half a percent of expenses. If that were the case and the misstatements found by the auditor were less than half a percent of expenses individually or collectively, then no adjustment would be needed. Alternatively, if the misstatements exceeded that amount, the auditor might qualify the audit opinion for those specific errors. Before doing that, however, the auditor presents these errors to management to allow them an opportunity to correct the errors.

The auditor must also consider qualitative factors. For instance, a discrepancy of a relatively small amount could have a material effect on the financial statements if 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 example, we included a qualification in our 2011/12 audit opinion on the Summary Financial Statements because the Province had not disclosed required financial information related to government business enterprises, even though this lack of disclosure had no impact on the reported balances in the financial statements.

In the case of British Columbia's 2012/13 Summary Financial Statements, the Auditor General qualified his report this year because the Province did not materially comply with GAAP.

During the audit, our Office identified 42 adjustments to be made. Government chose to adjust 15 of them. Of the remaining 27, we found three significant enough to be included as qualifications in the audit report:

- lack of full consolidation of the Transportation Investment Corporation;
- inappropriate deferral of government transfers revenue; and
- inappropriate deferral of restricted revenues.

Definitions

GAAP: Generally Accepted Accounting Principles

PSAS: Public Sector Accounting Standards (GAAP for all levels of government)

Material: something of significance to users of the financial statements

Opinion: the independent auditor's report as to the quality of the financial statements. It should be a "clean opinion" with no qualifications

Qualification: if certain parts of the financial statements do not follow GAAP or if not enough information is provided for users to make an informed decision, the auditor may include a qualification in the audit opinion to discuss the situation

Disclosure: the notes with financial statements that explain certain numbers or accounting policies

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

WHY QUALIFICATIONS MATTER

In the private sector, an audit report with qualifications can lower an entity's credit rating or its share price; or can increase 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 qualification, the British Columbia Securities Commission could place a "cease trade" order against it. The public corporation then runs the risk of being delisted by the stock exchange on which it is traded.

While governments are not subject to public corporation reporting requirements, a qualified audit report could impact a government's credit rating or cost of debt.[3]

According to the public sector accounting standards of the Chartered Professional Accountants Canada,[4] "governments are held to a higher standard of accountability than a business or a not-for-profit organization."[5] However, this does not seem to be the case in British Columbia, where the accountability for not complying with GAAP appears to have had little impact on government.

THE 2012/13 QUALIFICATIONS

We discuss each of our three qualifications in detail below.

Qualification 1: Full consolidation of the Transportation Investment Corporation is required

Statement of Problem

Our first qualification on the 2012/13 Summary Financial Statements concerns how the Province consolidates the Transportation Investment Corporation (TIC). For the last five years, Government has classified the TIC as a government business enterprise (GBE) and therefore consolidates it into the Summary Financial Statements using the modified equity method of accounting. In our opinion, this method of consolidation is not in accordance with the Public Sector Accounting Standards (PSAS). The TIC does not meet the criteria to be classified as a GBE and should instead be consolidated on a line-by-line basis of accounting. Doing that would have increased the Province's overall deficit in 2012/13 by $60 million.

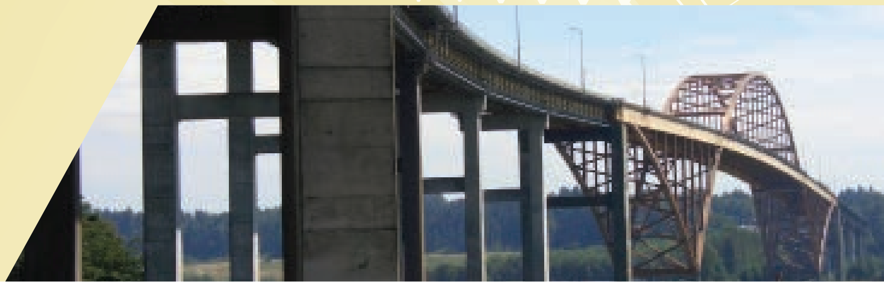
Background

The TIC is a public Crown corporation that was established to develop and operate toll highways. The first one is the Port Mann Highway Improvement project, which includes the new Port Mann Bridge and improvements to Highway 1. In December 2012, Government introduced tolls on the Port Mann Bridge, and it anticipates positive cash flows from the tolls by 2015/16.

How the Province consolidates the financial information for each of the public-sector entities it audits depends on the entity's classification under PSAS. For the purpose of the Summary Financial Statements, an entity can be either:

- part of government (e.g. a ministry),
- a government business enterprise (e.g. BC Lottery Corporation),
- a government not-for-profit enterprise (e.g. School District), or
- an other government organization (e.g. Oil and Gas Commission).

2 Other variables also impact these items.
3 Note that, to date, a qualified audit report has not impacted the Province's credit rating or cost of debt.
4 The Canadian Institute of Chartered Accountants and Certified Management Accountants Canada joined on January 1, 2013, to create Chartered Professional Accountants Canada.
5 Canadian Institute of Chartered Accountants, Public Sector Accounting Handbook, section 1100, appendix A, point 9.



GBEs are separate legal entities that have been delegated the financial and operational authority: (1) to carry on a business, such as ICBC or BC Hydro selling goods or services outside of the government reporting entity; and (2), in the normal course of operations, maintain their operations and meet their liabilities from revenue sources outside of the government reporting entity.

Most public-sector entities are consolidated on a line-by-line basis of accounting. The exception is GBEs, which are consolidated on the modified equity basis of accounting. 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.

The intent of consolidating GBEs on the modified equity basis is to avoid co-mingling independently managed business enterprise budgets and actual results with those of other taxpayer-supported government organizations. Consolidation also avoids including the business enterprise's debt with that of taxpayer-supported government organizations, as GBEs are expected to repay their debt from their own business revenues.

When a GBE is consolidated on a modified equity basis, only the initial investment (contribution) of money to the organization from the government (adjusted for annual earnings or losses) is included in the Province's financial statements. In addition, the accounting policies 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 gains or losses on the sale of assets).

Analysis

Accounting guidance on how the TIC should be classified and therefore how it should be consolidated in the Summary Financial Statements is given in the *Public Sector Accounting Handbook*, section 1300, "Government reporting entity":

> *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.

Under this definition, an entity must have all four characteristics to be classified as a GBE. If any one of the criteria is not met, the entity cannot be classified as a GBE.

As previously stated, the TIC started collecting tolls to use the Port Mann Bridge in late 2012. This means it has moved to "its normal course of operations" and now has a source of revenue from outside of the government reporting entity. However, total toll revenue earned in 2012/13 was $15 million while operating costs were $50 million – meaning that the TIC is currently unable to maintain its operations and meet its liabilities solely from sources of revenue outside the government reporting entity. Clearly then, the TIC does not meet the criteria set out in PS1300.28(d) of the *Public Sector Accounting Handbook* and cannot be classified as a GBE; and it therefore should not be consolidated on the modified equity basis.

Impact on the Summary Financial Statements

As a result of this inappropriate classification of the TIC, the impact on the March 31, 2013, Summary Financial Statements of fully consolidating the corporation on a line-by-line basis is:

$ Millions	March 31, 2013 As reported by the Province	After Auditor General's adjustment to fully consolidate the TIC	Difference
Consolidated statement of financial position			
Financial assets	37,528	35,202	(2,326)
Liabilities	75,664	75,950	286
Net liabilities	(38,136)	(40,748)	(2,612)
Non-financial assets (ie. capital assets)	39,521	42,205	2,684
Accumulated surplus	**1,385**	**1,457**	**72**
Consolidated statement of operations			
Revenue	42,055	42,020	(35)
Expense	43,201	43,226	25
Deficit for the year	**(1,146)**	**(1,206)**	**(60)**

The $60-million increase in the deficit for the year relates to realized losses on interest rate hedging transactions that instead would be recorded as an expense if the TIC was consolidated line-by-line.

The financial assets, liabilities, non-financial assets, revenues and expenses shown on the supporting Summary Financial Statements by sector (pages 88–95) and the supporting statements for self-supported Crown corporations and agencies (pages 96–99) would also be over- or understated by this inappropriate classification of the TIC by the amounts described above.

Conclusion and Recommendation

The TIC does not meet the definition of a GBE and should therefore be fully consolidated in the Summary Financial Statements on a line-by-line basis. Our Office will continue to review the status of the TIC each year to determine if it meets the definition of a GBE and can therefore be consolidated using the modified equity method.

Qualification 2: Inappropriate deferral of government transfers revenue

Statement of problem

The second qualification concerns how the Province should record revenue it receives from other governments. In 2012/13, Government deferred (i.e. accounted for as revenue at a later date) $1.945 billion of funds that it received from other governments, mainly the federal government. In keeping with the agreements signed when the funds were transferred, these funds can only be used for specific operations, or for the purchase or construction of specific capital assets (such as roads). Government in this province recognizes these funds as revenue over the terms of the agreements (for operating costs) or over the life of the asset (for capital assets).

In our opinion, Government's accounting is not in accordance with PSAS, which generally requires that these funds be recognized as revenue when received or as the assets are constructed. Doing so would increase revenue by $1.945 billion, altering the Province's bottom line from a deficit to a surplus.

Background

New accounting standards for government transfers came fully into effect this past year. The standards set stricter rules on what kinds of revenue can be deferred and accounted for as revenue at a later date. As it has in the past and continues to do, the British Columbia government recognizes the funds it receives for the construction of capital assets (e.g. hospitals and roads) as revenue over the same number of years as the life of the asset (or as it is amortized).

This is not in keeping with the new Canadian PSAS on government transfers. The new standards generally say that you have to recognize the revenue as the funds are used, which in most cases, means as the asset is built. (By comparison, a road may take only two years to build but have a useful life of 40 years.) On rare occasions, there may be a stipulation attached to the transfer that creates a liability (i.e. a situation where money is owed at a later date), which extends beyond the period of construction. If there is such a stipulation, the transfer can be deferred and recognized as revenue as the liability is amortized.

For example, in the past if the Province received $4 million from the federal government towards building a new highway with an anticipated 40-year life span, the Province would have "deferred the revenue" and only recorded revenue of $100,000 each year for 40 years. Now the new standard generally says that the entire $4 million needs to be recognized when the highway is built.

However, the Province's position is that all transfers received for operating purposes or for the construction or purchase of capital assets have stipulations attached to them, and therefore it can defer the revenue over the longer period.

Analysis

This is a one-time accounting adjustment that government should have made to bring its financial statements in line with the new accounting standards. *Public Sector Accounting Handbook*, section 3410, "Government transfers," contains guidance for determining how to account for, and report transfers from another government, in the Summary Financial Statements. For our detailed analysis on accounting for government transfers, see the *position paper we issued in June 2012*.

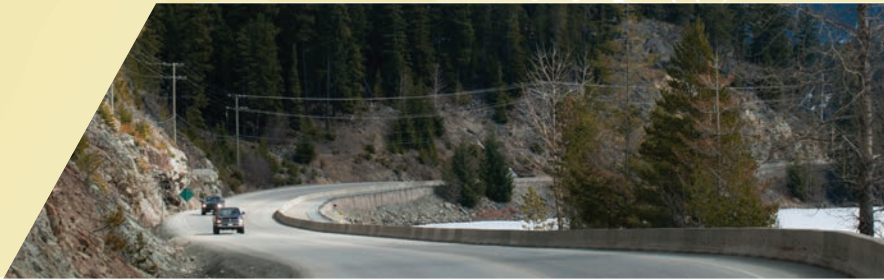
In our view, there are no stipulations attached to the majority of the *operating transfers*. As a result, these deferred transfers should be brought into revenue. The stipulations attached to the *capital transfers* only require them to be used to construct or purchase the capital assets. As a result, transfers received that are being deferred and amortized over the life of these capital assets should be brought into revenue once the assets are built or when purchased.

Impact on the Summary Financial Statements

The new accounting standard allows governments a choice to apply these standards on a "go forward" (prospective) basis or on a looking backward (retroactive) basis. When adjustments are needed, retroactive application is usually encouraged, since it provides a true comparison between the current and prior periods. However, sometimes the necessary information is not available to allow for retroactive application. The government informed us that it adopted the new accounting standard on a prospective basis, but its analysis of the new standard indicated that changes were not needed. Government said that all transfers received for operating purposes or for the construction or purchase of capital assets had stipulations attached to them and therefore it could continue to defer the revenue. Because these agreements did not contain stipulations beyond construction or purchase, we did not agree.

In our view, significant accounting adjustments are required as a result of the new standard being adopted, be it retroactively or prospectively. Had it been adopted on a retroactive basis, the financial impact on the statements of deferring these government transfers would be as follows:

	March 31, 2013		
$ Millions	**As reported by the Province**	**After Auditor General's adjustment to recognize revenue that should not be deferred**	**Difference**
Consolidated statement of financial position			
Financial assets	37,528	37,528	-
Liabilities	75,664	73,719	(1,945)
Net liabilities	(38,136)	(36,191)	1,945
Non-financial assets (ie. capital assets)	39,521	39,521	-
Accumulated surplus	**1,385**	**3,330**	**1,945**
Consolidated statement of operations			
Revenue	42,055	42,168	113
Expense	43,201	43,201	-
(Deficit) / Surplus for the year	**(1,146)**	**(1,033)**	**113**

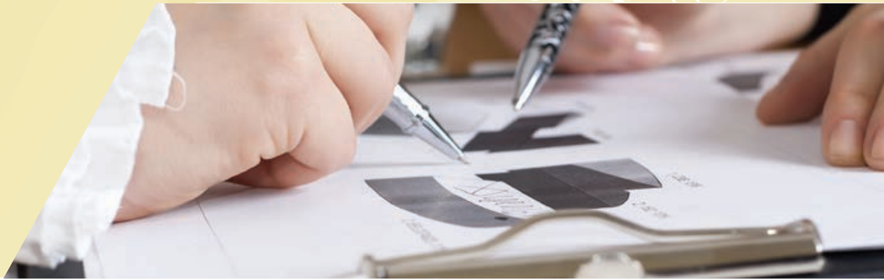


Instead, however, the government adopted the standard on a prospective basis. Therefore, our audit opinion had to present the accounting changes that, in our view, needed to be made to ensure the statements were in line with the new standards. As a result, the financial impact on the statements of deferring these government transfers would be as follows:

	March 31, 2013		
$ Millions	**As reported by the Province**	**After Auditor General's adjustment to recognize revenue that should not be deferred**	**Difference**
Consolidated statement of financial position			
Financial assets	37,528	37,528	-
Liabilities	75,664	73,719	(1,945)
Net liabilities	(38,136)	(36,191)	1,945
Non-financial assets (ie. capital assets)	39,521	39,521	-
Accumulated surplus	**1,385**	**3,330**	**1,945**
Consolidated statement of operations			
Revenue	42,055	44,000	1,945
Expense	43,201	43,201	-
(Deficit) / Surplus for the year	**(1,146)**	**799**	**1,945**

Conclusion and Recommendation

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



Qualification 3: Inappropriate deferral of restricted revenues

Statement of problem

The third qualification concerns the inappropriate deferral of externally restricted funds received from non-government sources, such as money donated to a university from a private donor, specifically to purchase computers.

In 2012/13, the Province deferred $1.01 billion of externally restricted revenues received from non-government sources, and is recognizing the money over the life of the assets. These funds were restricted to the purchase or construction of capital assets. In our opinion, Government's accounting is not in accordance with public sector accounting standards (GAAP). PSAS requires that these funds be recognized in revenue as the conditions for earning it are met.

Background

This qualification is very similar to the second one. The main difference is that in this situation the money is coming to government from non-government sources whereas in the previous qualification the money came from other governments. Because the accounting standards for each of these situations comes from different sections of the *Public Accounting Sector Handbook*, we must provide separate qualifications for each situation, even though the two are very similar.

The new accounting standards for government transfers set stricter rules on what kinds of revenues can be deferred. As it has in the past and continues to do, the British Columbia government defers funds received from non-government sources and recognizes those funds as revenue in the statement of operations when the related expenditures occur.

The Province's position for externally restricted funds received for operating purposes is to recognize them as revenue on the same basis as the related expenditures occur. This is in accordance with Canadian public sector accounting standards. However, the Province's position for externally restricted funds received for the purchase or construction of capital assets is to recognize them as revenue at the same time as the related assets are amortized. This is not in accordance with Canadian public sector accounting standards.

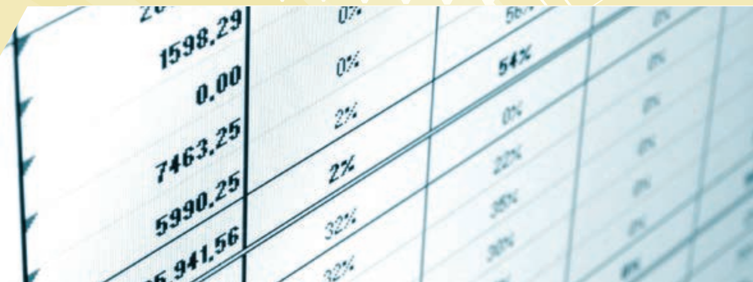
Canadian public sector accounting standards require that governments recognize externally restricted funds that they receive as revenue in the period in which the funds are used for the purposes specified.

Analysis

Public Sector Accounting Handbook, section 3100, "Restricted assets and revenues," contains the accounting guidance for determining how to account for and report externally restricted revenues received from non-government sources in the Summary Financial Statements:

> *Per PS3100.11:*
>
> Externally restricted inflows should be recognized as revenue in a government's financial statements in the period in which the resources are used for the purpose or purposes specified. An externally restricted inflow received before this criterion has been met should be reported as a liability until the resources are used for the purpose or purposes specified.

In our view, the purpose specified for use of the funds is to either construct or purchase the capital asset. As a result, funds received that are being deferred and amortized over their life should be brought into revenue when the asset has been built or purchased.



Impact on the Summary Financial Statements

As we note under the government transfers section in the Qualification 2 section, had the Province made the change on a retroactive basis, the financial impact on the statements of deferring these restricted revenues would be as follows:

$ Millions	March 31, 2013 As reported by the Province	After Auditor General's adjustment to recognize revenue that should not be deferred	Difference
Consolidated statement of financial position			
Financial assets	37,528	37,528	-
Liabilities	75,664	74,654	(1,010)
Net liabilities	(38,136)	(37,126)	1,010
Non-financial assets (ie. capital assets)	39,521	39,521	-
Accumulated surplus	**1,385**	**2,395**	**1,010**
Consolidated statement of operations			
Revenue	42,055	42,073	18
Expense	43,201	43,201	-
(Deficit) / Surplus for the year	**(1,146)**	**(1,128)**	**18**

In our audit opinion, however, we presented the change on a prospective basis because that is the approach the Province chose to adopt. The financial impact on the statements of deferring these restricted revenues would be like this:

$ Millions	March 31, 2013 As reported by the Province	After Auditor General's adjustment to recognize revenue that should not be deferred	Difference
Consolidated statement of financial position			
Financial assets	37,528	37,528	-
Liabilities	75,664	74,654	(1,010)
Net liabilities	(38,136)	(37,126)	1,010
Non-financial assets (ie. capital assets)	39,521	39,521	-
Accumulated surplus	**1,385**	**2,395**	**1,010**
Consolidated statement of operations			
Revenue	42,055	43,065	1,010
Expense	43,201	43,201	-
(Deficit) / Surplus for the year	**(1,146)**	**(136)**	**1,010**

Conclusion and Recommendation

Externally restricted funds received from non-government sources should be reported as revenue in the period in which the funds are used for the purposes specified.

Overall impact of the qualifications

If the Summary Financial Statements were prepared fully in accordance with Canadian public sector accounting standards and the transfers recorded on a prospective basis as required by government, the recorded net liabilities for the year would have been $343 million lower and the recorded deficit for the year would have been $2.895 billion lower. This would have resulted in a surplus for the year of $1.749 billion.

	March 31, 2013				
$ Millions	**As reported by the Province**	**Qualification 1: Auditor General`s adjustment to fully consolidate the TIC**	**Qualification 2: Auditor General's adjustment to recognize government transfers revenue that should not be deferred**	**Qualification 3: Auditor General's adjustment to recognize restricted revenue that should not be deferred**	**As would be reported after Auditor General's adjustments**
Consolidated statement of financial position					
Financial assets	37,528	(2,326)	-	-	35,202
Liabilities	75,664	286	(1,945)	(1,010)	72,995
Net liabilities	(38,136)	(2,612)	1,945	1,010	(37,793)
Non-financial assets (ie. capital assets)	39,521	2,684	-	-	42,205
Accumulated surplus	**1,385**	**72**	**1,945**	**1,010**	**4,412**
Consolidated statement of operations					
Revenue	42,055	(35)	1,945	1,010	44,975
Expense	43,201	25	-	-	43,226
(Deficit) / Surplus for the year	**(1,146)**	**(60)**	**1,945**	**1,010**	**1,749**

However, if the transfers had been recorded on retroactive basis, while the recorded net liabilities for the year would have been $343 million lower, as noted above, the recorded deficit for the year would have been $71 million lower, which would have resulted in a deficit for the year of $1.075 billion.

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: COMMON QUESTIONS AND ANSWERS

Why is there a $2.9-billion difference between the Province's final total for 2012/13 and the Auditor General's?

Most of the difference relates to new accounting standards that governments across Canada were required to adopt last year. The new standards set stricter rules about what kinds of revenue can be deferred (meaning accounted for as revenue at a later date) rather than recognized as revenue in the year it was received or very shortly thereafter. Each party is interpreting the standard differently. The Auditor General based his opinion on his interpretation of the Public Sector Accounting Standards (PSAS).

Is the provincial government using different accounting rules?

No. Government is required by legislation to prepare its Summary Financial Statements according to Canadian generally accepted accounting principles (GAAP), which is the industry standard. All levels of government across Canada use a form of GAAP specifically designed for the public sector, called Public Sector Accounting Standards (PSAS). Both our Office, other firms and the Province are using the same rules; we just don't agree with how the Province has chosen to interpret them.

Does balanced-budget legislation have anything to do with the difference?

Government introduced balanced-budget legislation in 2001. Similar legislation has been passed in the majority of Canadian provinces since then. Balanced-budget legislation can be used with other measures as a budget management tool to help manage spending compared to projected revenue and can help demonstrate a government's commitment to fiscal responsibility.

When you purchase or build an asset, there is the initial cash outlay for the purchase or construction of the asset, but then there is also the amortization cost over the life of the asset. With balanced-budget legislation, you need revenue to cover the annual amortization cost for the duration of the assets useful life, so clearly government would prefer to defer the funds it received and use it to cover (match) the amortization expense.

Accounting standards have generally moved away from this "matching principle", making balancing the budget according to standards more difficult, but not insurmountable.

We have also noticed other unintended consequences of balanced budget legislation including the build up of excess working capital, and the focus on short-term financial performance. We have reported on these issues in several reports of the Office.

Government adopted this new standard on a "prospective" basis as opposed to a "retroactive" basis, but has not changed its accounting practices either way. How does that work?

With a new standard, there is usually a choice between adopting it retroactively or prospectively. Retroactive adoption, which would require previous periods to be restated to reflect the new standards, is usually encouraged since the current and prior years are then comparable.

However, the government has adopted the standard prospectively, and its view is that the new standard does not result in any changes. This interpretation of the standard is different from the Auditor General's and many of his colleagues in the auditing profession. The new standard results in changes for the government, hence our qualification.

How can there be such a large difference in the bottom line by adopting the standard retroactively versus prospectively?

The new standard applies to transfers that were deferred as of April 2012. All deferrals at that time that did not meet the new standard had to be brought into revenue. Because of adopting the new standard prospectively, the government had to bring all that money into revenue at one time, which makes it seem like there is suddenly a significant surplus. Had the government adopted the standard retroactively and restated the prior periods for a fair comparison, then the money brought into revenue would have been from transfers received.

Given that all governments across Canada follow the same accounting standards, what are other jurisdictions doing in relation to these transfer funds and the new standards?

It is a little early to say what other governments and Auditors General across Canada will do. As of July 31, 2013, only Alberta and Saskatchewan had issued their audited 2013 financial statements.

The Government of Saskatchewan recognized that a change needed to be made, and an additional $114 million in revenue was recorded. The Auditor General agreed with this.

Alberta defers the revenue it receives through transfers over the life of the asset if the stipulations in the transfer state this. That is what the standard says. However, because we don't know the details of the transfers received by the Alberta government, we cannot comment as to whether Alberta followed suit with British Columbia.

Our Office relies on about 30 private-sector audit firms to assist in completing our audit of the Province's Summary Financial Statements. Each of the "big six" firms (Deloitte; Ernst & Young; PricewaterhouseCoopers; KPMG; BDO; and Grant Thornton), agreed that there would likely be significant differences between the new standard and how it had previously been accounted for.

If this comes down to a difference in interpretation of the standards between some of British Columbia's most senior and qualified accountants, who "breaks the tie"?

The provincial government has a responsibility to issue financial statements and attests to their reliability and conformity to standards. Independent auditors have a duty to report on the fairness of the financial statements against the same standard. Users of financial statements are well served by this outside assessment, as it is independent of any influences or possible biases that may be present in government. Effectively then, there is no tie to break. Instead, users can take the information and form their own view as to whether or not the financial statements are fairly presented and reliable.

What does this mean for British Columbians?

These accounting adjustments are important to make to bring the Province in line with the new accounting standards. Making them, however, does not mean there will be a surplus of cash on hand, as the money received is already tied to specific projects and accounted for. Therefore, there is no impact on services to British Columbians.

There is no real choice whether to adopt standards. While British Columbians often look to the bottom line as an indicator of our province's fiscal health, other indicators are equally as important.

For instance, looking at the Province's cash flow statement to ensure it has enough cash on hand to cover its operating expenses and interest costs is also very important.

What government is doing is deferring revenues and recognizing them at a later date so there is less volatility and avoids being offside with its balanced-budget legislation. By deferring this revenue, government is saying this is a liability when in fact that is not the case.