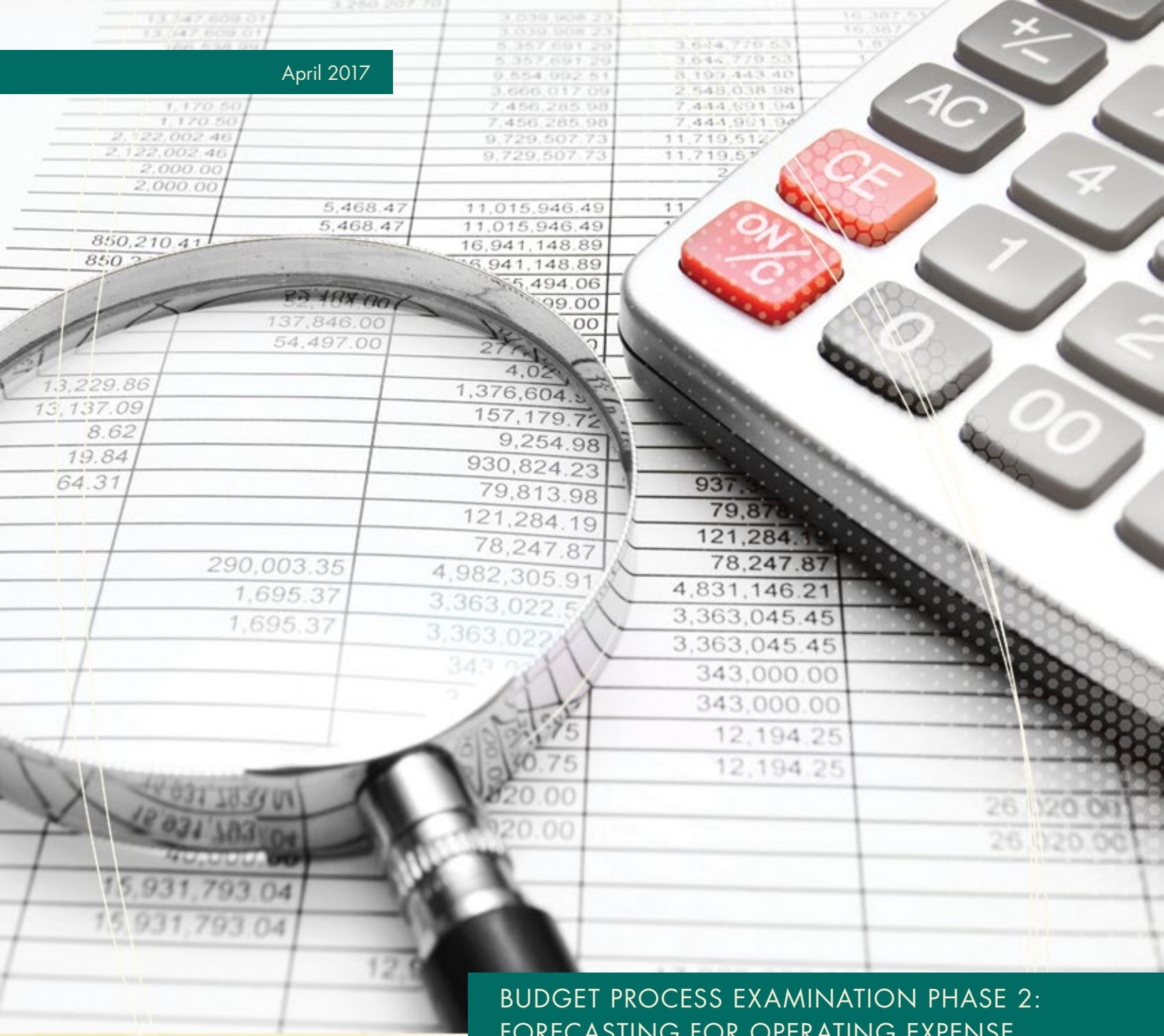


April 2017



BUDGET PROCESS EXAMINATION PHASE 2:
FORECASTING FOR OPERATING EXPENSE,
CAPITAL SPENDING AND DEBT

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Auditor General
of British Columbia

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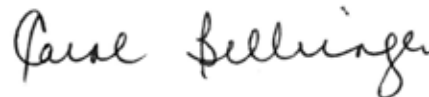
623 Fort Street
Victoria, British Columbia
Canada V8W 1G1
P: 250.419.6100
F: 250.387.1230
www.bcauditor.com

The Honourable Linda Reid
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
V8V 1X4

Dear Madame Speaker:

I have the honour to transmit to the Speaker of the Legislative Assembly of British Columbia the report *Budget Process Examination Phase 2: Forecasting for Operating Expense, Capital Spending and Debt*.

We conducted this examination under the authority of section 11 (8) of the *Auditor General Act* and in accordance with the standards for assurance engagements set out by the Chartered Professional Accountants of Canada (CPA) in the CPA Handbook - Assurance and Value-for-Money Auditing in the Public Sector, Section PS 5400.



Carol Bellringer, FCPA, FCA
Auditor General
Victoria, B.C.
April 2017

AUDITOR GENERAL'S COMMENTS

PREPARING THE PROVINCIAL budget is a complex process that involves information from over 150 government entities. Preparing a budget within the context of legislation that prohibits government from forecasting a deficit – and sets consequences if financial results achieved do not meet the requirements of balanced budget legislation – adds further complexity to developing forecasts that are flexible enough to accommodate unplanned revenue or expense variations.

This is the second of two reports based on our examination of the B.C. government's budgeting process.

Our June 2015 report discussed government's 2014/15–2016/17 revenue forecasts and the process used to create them. We made three recommendations to the Ministry of Finance to improve the clarity and transparency of future budgets for readers. Government has addressed all three of the recommendations.

In this new report, we discuss how government approached forecasting operating expense, capital spending and debt in Budget and Fiscal Plan 2015/16–2017/18. Our goal in this second part of the examination was to determine whether the:

- ◆ assumptions underlying the forecasts were well supported and provided a reasonable basis for the forecast
- ◆ forecasts reflected the assumptions
- ◆ presentation and disclosure of the Budget and Fiscal Plan were in keeping with Canadian accounting standards for future-oriented financial information
- ◆ requirements of relevant provincial legislation were met

We concluded that the forecasting processes used by government to estimate operating expense, capital spending and debt met all of these



CAROL BELLRINGER, FCPA, FCA
Auditor General

AUDITOR GENERAL'S COMMENTS

expectations. However, we also noted two areas where government could improve the clarity and transparency of budget information for readers: debt balances, and disclosures of the assumptions underlying key changes.

We therefore made two recommendations for government. As well, we provided the Ministry of Finance with a management letter that outlined less significant recommendations to help the ministry further improve its budgeting processes and disclosures.

With these two reports, we have examined all of the main components of government's budgeting process. Generally, we found that government was doing a good job preparing and reporting the budget forecasts and we concluded that government's overall budget process was sound.

It's worth mentioning that budgets are always a best estimate, regardless of the quality of information or the process used to prepare them. This is just as true for the provincial government as it is for the finances in a business or a household. Actual results will always vary. But it is important in all cases to control one's finances as much as possible by keeping an eye on how well results compare to the budgets and understanding why they differ. In 2015/16, the actual surplus was \$730 million, compared with the budgeted surplus of \$284 million. Government's [2016 Financial and Economic Review](#) (Part 2) explains the changes between the budget and actual results.

I would like to thank the Ministry of Finance staff who worked with us during this examination.



Carol Bellringer, FCPA, FCA
Auditor General
Victoria, B.C.
April 2017

REPORT HIGHLIGHTS

PHASE 1:

Forecasting
revenue

Budget and Fiscal Plan
2014/15 – 2016/17

1

WE EXAMINED

all the main
components of
government's

BUDGETING PROCESS

PHASE 2:

Forecasting
operating expense,
capital spending
& debt

Budget and Fiscal Plan
2015/16 – 2017/18

2

THE PROCESS IS SOUND

BUDGET FORECASTS ARE ESTIMATES

Actual results
will vary

BUDGET FORECASTING in government is COMPLEX

Includes over

150
entities

SUMMARY OF RECOMMENDATIONS

WE RECOMMEND THAT THE MINISTRY OF FINANCE:

- 1** inform readers of the reasons for, and effects of, using a different presentation for the debt balances in the main chapter of the *Budget and Fiscal Plan* than for the debt balances in the *Summary Financial Statements*.
- 2** enhance disclosure of the key assumptions supporting significant changes in projected caseload trends for statutory programs, to allow readers to understand the reasons and risks behind the changes.

RESPONSE FROM THE MINISTRY OF FINANCE

GOVERNMENT WOULD LIKE to thank the Office of the Auditor General for this report on the forecasting processes for operating expenses, capital spending, and debt. This report, in conjunction with the *Budget Process Examination Phase 1: Revenue* report released in June 2015, represents several years of work by the Office of the Auditor General reviewing all of the main components of government's budgeting process.

We are pleased that the Office of the Auditor General concluded that government's overall budget process is sound. This independent and objective assurance of government's budget process should provide British Columbians with increased confidence in the quality and credibility of the annual budget's key assumptions, forecasts, presentation, and disclosures. Government also recognizes the importance of having the Office of the Auditor General provide recommendations for continuous improvement, which will enhance the clarity and transparency of budget information for readers.

Government accepts both recommendations in this report. With respect to the first recommendation, additional information was provided in Budget and Fiscal Plan 2017/18-2019/20 to explain that the presentation of provincial debt in the main chapter of the Budget and Fiscal Plan document is consistent with the Debt Summary Report included in the Public Accounts. There is also specific reference to the reconciliation between provincial debt and the financial statement debt in the most recent Budget and Fiscal Plan document. The second recommendation will be taken into consideration and addressed during future budget processes.

We are also pleased that the Office of the Auditor General concluded that the Ministry of Finance has addressed all three of the recommendations from the *Budget Process Examination Phase 1: Revenue* report.

Lastly, government expresses its gratitude to the Auditor General and her staff for their work examining the main components of the budgeting process. This has been a collaborative and professional engagement that has served British Columbians well through the continuous improvement of our budget process.

BACKGROUND

THE B.C. GOVERNMENT'S financial management framework includes the legislation, policy and activities necessary to support the effective stewardship of public funds.

The framework, which covers an annual cycle of financial planning through to monitoring and reporting, applies to the more than 150 organizations in the public sector that are controlled by government ([Exhibit 1](#)). These 150 organizations are collectively referred to as the government reporting entity (GRE), and they fall into one of the following three groups:

- ◆ core government: all ministries and legislative offices that spend money directly out of the Consolidated Revenue Fund (CRF; core government's main operating account)
- ◆ service delivery agencies: school districts, universities, colleges, health organizations and taxpayer-supported Crown corporations and agencies that receive significant funding in the form of grants from core government
- ◆ self-supported Crown corporations: government corporations, such as BC Hydro and BC Lottery Corporation, that do not receive operating grants from core government. These bodies are defined as self-supported because they sell goods or services to individuals and organizations outside of government and are able to meet their continued operations from these revenues

Each year, the government's cycle of financial management includes the following main steps:

- ◆ Government tables a Budget and Fiscal Plan for the GRE. The budget is a benchmark to

measure against actual financial performance at the end of a fiscal year, when compared with government's independently audited financial statements.

- ◆ The Ministry of Finance provides quarterly updates on the forecasts against the tabled Budget and Fiscal Plan.
- ◆ The Ministry of Finance reports actual results for the fiscal year, with comparisons to budget and prior-year results, in the Public Accounts. The Public Accounts include the Province of British Columbia's audited Summary Financial Statements and other key financial information for the past fiscal year.
- ◆ Shortly after issuing the Public Accounts, government releases its Financial and Economic Review, which provides a more detailed comparative analysis of actual results and the budgeted amounts.

The milestones in the budget and fiscal planning process are shown in [Appendix A](#).

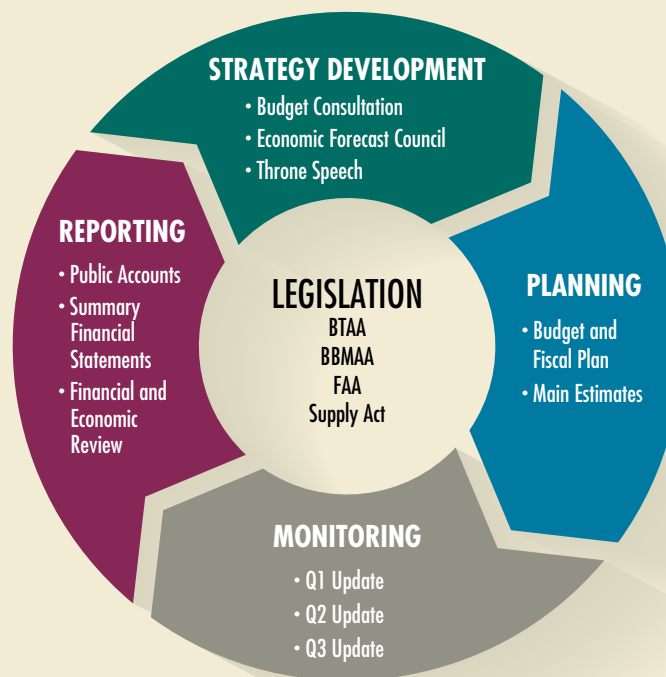
Legislation is at the core of the financial management framework, setting out roles, responsibilities and accountabilities for various levels of government. The key legislation is the following:

- ◆ The *Budget Transparency and Accountability Act* (BTAA) sets out government's primary reporting requirements through all phases of

BACKGROUND

- financial accountability, from the budget and quarterly updates for the GRE to the annual Public Accounts.
- ◆ The *Balanced Budget and Ministerial Accountability Act* (BBMAA; often referred to as the balanced budget legislation), prohibits government from forecasting a deficit for the fiscal year, provides the basis for calculating a surplus or deficit, and sets out the terms of minister salary holdbacks. Ministers have both collective and individual responsibilities that must be met in order to receive 100% of the salary holdback.
 - ◆ For core government:
 - ◆ The *Financial Administration Act* (FAA) establishes the primary authorities and responsibilities for the control and management of government finances – assets, liabilities, expenditures, revenues, borrowing, lending and investing.
 - ◆ A *Supply Act* provides the annual authorization from the Legislature for core government to spend money from the CRF for the authorized purposes. Legislative authorization is required under the FAA to spend money from the CRF.

Exhibit 1: B.C.'s financial management framework



Source: Office of the Auditor General of British Columbia

BACKGROUND

The primary method to authorize such spending is for the Legislature to annually pass a *Supply Act*, which authorizes certain spending in a fiscal year in accordance with the purposes and amounts specified in the Estimates presented with the budget for the year.

- ◆ For service delivery agencies and self-supported Crown corporations, each entity's enabling legislation establishes the authorities and responsibilities for the control and management of that entity's finances. For example, the *School Act* defines the financial management framework for all 60 school districts in the province.

expected economic conditions, as well as its forecasted revenues, expenses, capital spending and debt for the next three years.

Every year, the Minister of Finance tables the Budget and Fiscal Plan in the Legislative Assembly, on the third Tuesday of February.

- ◆ The main Estimates provide a detailed breakdown of expected spending by the GRE in the coming fiscal year. For core government (whose funds come from the CRF), the main Estimates are also the basis for the annual appropriations (meaning money set aside for specific purposes) that Members of the Legislative Assembly must debate and approve.

THE B.C. BUDGET PROCESS

Budgets are forward-looking documents that provide a forecast of financial results based on expectations and assumptions about the future.

In B.C., the budget process is coordinated by Treasury Board Staff, a division in the Ministry of Finance. Treasury Board Staff compiles the budgets from all GRE organizations to produce two key public documents: the Budget and Fiscal Plan and the main Estimates:

- ◆ The primary document is the Budget and Fiscal Plan. It presents a three-year plan that includes a budget for the upcoming year, forecasts for the following two years, and an updated forecast for the current period. The plan also includes government's assessment of

OUR PHASED APPROACH

The Office of the Auditor General has taken a phased approach to examining government's budget process. In Phase 1, we examined the economic and revenue forecast processes government used for Budget and Fiscal Plan 2014/15–2016/17 (tabled in the Legislature on February 18, 2014). In June 2015, we released [Budget Process Examination Phase 1: Revenue](#), reporting our findings.

For Phase 2, the subject of this report, we examined the processes government used to forecast operating expense, capital spending and debt in [Budget and Fiscal Plan 2015/16–2017/18](#) (tabled on February 17, 2015).

[Exhibit 2](#) shows a summary of Budget and Fiscal Plan 2015/16–2017/18, highlighting the scope of each phase of our budget examination.

BACKGROUND

Exhibit 2: Summary of Budget and Fiscal Plan 2015/16 – 2017/18

(\$ Millions)	Budget Estimate 2015/16	Plan 2016/17	Plan 2017/18
Revenue	46,365	47,646	48,617
Expense	45,831	46,920	47,868
Surplus before forecast allowance	534	726	749
Forecast allowance	(250)	(350)	(350)
Surplus	284	376	399
Total capital spending	6,249	6,253	6,143
Total provincial debt	65,960	68,245	70,404

Source: Office of the Auditor General of British Columbia

- Phase 1: Examined Budget and Fiscal Plan 2014/15-2016/17
- Phase 2: Examined Budget and Fiscal Plan 2015/16-2017/18

Budget forecasting in government, the private sector and one's own household involves essentially the same components: a forecast of how much money is coming in the door (revenue), how much is going out for day-to-day costs (operating expenses) and major purchases (capital spending), and, if what comes in does not cover what goes out, how much will have to be borrowed (debt) to pay the bills.

One key difference, however, is the role of legislation in government budget forecasting. The balanced budget legislation prohibiting government from forecasting a deficit in the main Estimates for the fiscal year affects operating expense forecasts. Those forecasts cannot be higher than revenue forecasts for the fiscal year. Therefore, one of the first steps in

preparing the Budget and Fiscal Plan is to forecast revenue. Doing this determines how much money will be available for annual operating expenses.

Although the BBMAA does not prohibit a deficit in the actual results for the year, the BBMAA requires holdbacks for ministers' salaries and such holdbacks are only made due and payable to the applicable minister if the financial results provided for in the BBMAA are achieved (such as the GRE achieving at least 50% of the surplus estimated in the budget).

BACKGROUND

AUTHORITY TO SPEND

Service delivery agencies and self-supported Crown corporations get their authority to spend from their enabling legislation, which in turn is supported by a budget approved by their governing board.

Spending by core government is governed by the *Financial Administration Act*, which prohibits any money being spent from the CRF without the authority of an appropriation. There are three main kinds of appropriation:

1. voted appropriation authorized under a *Supply Act*: Operating expense budgets for core government are referred to as voted appropriations. There are also voted appropriations for capital spending. The term “vote” comes from the fact that each budget amount is presented in the main Estimates and debated and voted on by the Members of the Legislative Assembly. The *Financial Administration Act* requires that each voted appropriation be spent only for the purpose for which it was authorized. Generally, this means that government cannot move amounts between voted appropriations to manage over- and under-spending in programs.

Core government’s 2015/16 operating expense voted appropriations, excluding the Contingencies vote, totalled \$39.488 billion ([Exhibit 3](#)).

2. supplementary voted appropriation: If spending from voted appropriations is forecast to exceed that originally authorized under a *Supply Act*, supplementary estimates may be presented

to the Legislative Assembly for approval. Since 2013, however, the BTAA has restricted the use of supplementary estimates until the provincial government’s direct operating debt is eliminated.

For a program that anticipates overspending in a vote, another option is to request access to the Contingencies vote. The Contingencies vote is a voted appropriation that is not program specific. Amounts can be paid from the Contingencies vote to provide the authority for unanticipated spending, either directly or through a transfer to an applicable program vote. For 2015/16, the authorized spending from the Contingencies vote totalled \$350 million ([Exhibit 3](#)).

3. statutory appropriation: For core government, the authority to spend can also come from a statutory appropriation, which is the authority to spend money out of the CRF through a statute other than a *Supply Act*. Statutory appropriation is established when the legislation comes into force: annual spending is not debated and voted on each year. One of the reasons for using statutory appropriations is where the amount of annual expenses is difficult to estimate, but government has no way of avoiding the costs. An example is the annual cost for fighting wildfires. Specific wording in the *Wildfire Act* (section 65) allows the Minister of Forests, Lands and Natural Resource Operations to spend whatever is necessary to address the costs associated with forest fires. There are also many statutory appropriations where even the potential need to use them in a given year is not known or difficult to predict.

BACKGROUND

Because of their uncertainty, many statutory appropriations are not forecast in the Budget and Fiscal Plan. However, any amount spent under the authority of a statutory appropriation must be managed within the overall Budget and Fiscal Plan.

Exhibit 3 summarizes 2015/16 forecast operating expenses for core government and service delivery agencies, and identifies where the authority to spend occurs. Expenses from self-supported Crown corporations are not part of the consolidated expense budget because they are included in the revenue forecasts on a net basis (using the modified equity basis, instead of line-by-line consolidation).

Exhibit 3: Operating expense forecast, and authority to spend, 2015/16

	Budget Estimate 2015/16 (\$millions)
Core government expense (authorized by a <i>Supply Act</i>)	
Core government voted appropriations (excluding Contingencies vote)	39,488
Contingencies vote	350
Less: Ministry grants to service delivery agencies	(22,477)
Core government direct program spending	17,361
Service delivery agency expense (authorized by each agency's enabling legislation)	
Service delivery agency expense – funded from core government grants	22,477
Service delivery expense – self-funded	5,993
Total service delivery expense (from board-approved budgets)	28,470
Total forecast operating expense	45,831

Source: Office of the Auditor General of British Columbia, based on Table 1.8: Budget and Fiscal Plan 2015/16–2017/18

BACKGROUND

FORECASTING OPERATING EXPENSE

The operating expense forecast for 2015/16 was \$45.831 billion ([Exhibit 3](#)): \$17.361 billion for core government program spending and \$28.470 for service delivery agencies.

To forecast operating expenses, it is reasonable and necessary to anticipate and plan for unexpected events that might lead to changes in forecast amounts. However, as noted before, the balanced budget legislation imposes restrictions on how the province can plan and manage for unanticipated changes within the overall fiscal plan. This results in the need for a budget that provides some flexibility to manage unexpected expenses or revenue shortfalls.

To manage forecast risks and help ensure fiscal plan targets are met or exceeded within the current legislative constraints, government exercises prudence in its fiscal planning. As described on page 3 in Budget and Fiscal Plan 2015/16–2017/18, government uses four main levels of prudence:

1. for the ministry outlook for B.C.'s real GDP growth, an outlook that is lower than that of the Economic Forecast Council
2. for the natural gas revenue forecast, a price that is within the lowest 20th percentile of the private sector's forecasts
3. a forecast allowance to guard against revenue volatility (\$250 million in 2015/16)
4. a Contingencies vote to help manage unexpected or uncertain pressures and to fund priority initiatives (\$350 million in 2015/16)

Using a lower GDP growth rate assumption leads to a lower (more conservative) forecast for provincial revenues. The same is true for the conservative estimate of natural gas revenue prices. So, to meet the requirements of the balanced budget legislation, the revenue forecast establishes the amount of available funding for operating expense forecasts. A prudent revenue forecast provides a cushion for the forecast surplus.

The forecast allowance is an amount that the Minister of Finance sets aside to protect against downside revenue forecast risks and potential statutory appropriation spending. This allowance amount is not allocated to a specific revenue or expense category. As [Exhibit 2](#) shows, the allowance is presented after the forecasts of both revenue and expense as an added cushion to the forecasted surplus.

The Contingencies vote is an amount determined by the Minister of Finance that is focused on the expenditure side of the budget. It is one of the voted appropriations authorized under a *Supply Act*. The Minister of Finance, with the approval of Treasury Board, can allocate amounts from the Contingencies vote towards, among other things, the purposes of other voted appropriations to cover cost pressures from unanticipated and contingent events.

FORECASTING CAPITAL SPENDING AND DEBT

The total capital spending forecast for 2015/16 was \$6.249 billion and the debt forecast was \$65.960 billion ([Exhibit 2](#)). These two forecasts are closely

BACKGROUND

linked. Capital spending must be financed by either using cash from operations or taking on additional debt. Because only small surpluses were forecast in all three years of Budget and Fiscal Plan 2015/16–2017/18, the majority of capital spending forecast must be funded through added debt.

With a long list of government capital projects in need of funding, the decision for government becomes how much debt to take on.

Unlike for operating expense forecasts, there are no legislative constraints on how much government can forecast for capital investments and debt. There is, however, a market restriction based on government's stated objective in the Budget and Fiscal Plan to maintain a triple-A (AAA) credit rating. Credit ratings are based in part on a government's ability to manage its debt.

DEBT MANAGEMENT

Government's debt management strategy is summarized in [Budget and Fiscal Plan 2015/16–2017/18 \(pg. 50-51\)](#). The key metrics in the strategy are the level of taxpayer-supported debt, the ratio of taxpayer-supported debt to gross domestic product (GDP), and the ratio of taxpayer-supported debt to revenue.

OBJECTIVES AND SCOPE

WE EXAMINED THE forecasting processes government used to estimate operating expense, capital spending and debt for Budget and Fiscal Plan 2015/16–2017/18. We wanted to determine whether:

1. government's key assumptions were suitably supported, were consistent with government's plans, and provided a reasonable basis for the forecast
2. the forecasts fairly reflected these material assumptions
3. the presentation and disclosure of the Budget and Fiscal Plan were consistent with the general principles established in the Canadian accounting standards for future-oriented financial information
4. the budgeting and Estimates requirements of the *Budget Transparency and Accountability Act* (BTAA) and *Balanced Budget and Ministerial Accountability Act* (BBMAA) had been met

We used the same examination criteria that we developed for our Phase 1 (Revenue) examination. Those were based on assurance standards for future-oriented financial information issued by Chartered Professional Accountants (CPA) Canada, supplemented by guidance issued by the American Institute of Certified Public Accountants. As well, we reviewed similar assurance work conducted in other jurisdictions. Our criteria also included applicable requirements of B.C. legislation.

Our focus was on the systems, methods and processes the Ministry of Finance used to prepare the forecasts for operating expense, capital spending and debt in the

Budget and Fiscal Plan. Our examination procedures included enquiry, analytics and discussion related to the criteria.

FUTURE-ORIENTED FINANCIAL INFORMATION

Financial information about probable results, based on expectations about future economic circumstances and strategies (or courses of action).

OUTSIDE THE SCOPE OF OUR EXAMINATION

The annual budget is, in effect, a policy document that reflects the financial implications of government's priorities. Questioning the merits of program policies or government objectives as reflected in this Budget and Fiscal Plan was beyond our mandate (see Section 11(9) of the *Auditor General Act*).

Because the forecasts for operating expense, capital spending and debt are based on future conditions and events, actual results always vary and those variances may be significant. Our examination therefore didn't try to provide assurance on whether government will achieve the forecasted results.

OBJECTIVES AND SCOPE

We did not examine the budgeting processes at individual service delivery agencies. They are, in general, required to prepare balanced budgets. However, we did test that agency boards had approved the agency budget, to ensure oversight of the underlying forecast assumptions.

For this report we did not examine the revenue and economic forecasts in the Budget and Fiscal Plan. We discussed these components for Budget and Fiscal Plan 2014/15–2016/17 in our report, [*Budget Process Examination Phase 1: Revenue*](#).

Although we reviewed the [*Estimates, Supplement to the Estimates*](#) and [*ministry service plans*](#) as part of this examination, we have not included them as part of the scope of this report and we provide no assurance on those documents.

CONCLUSIONS

BASED ON OUR examination of Budget and Fiscal Plan 2015/16–2017/18, we concluded the following:

- ◆ The key assumptions used in forecasting the operating expense, capital spending and debt were suitably supported and consistent with government's plans and that they provided a reasonable basis for the forecasts.
- ◆ The forecasts accurately reflected the key assumptions.
- ◆ The presentation and disclosure were consistent with principles in the Canadian accounting standards for future-oriented financial information. However, we identified two areas where government can improve presentation and disclosure so that readers can better understand the key assumptions and related risks and sensitivities underlying the forecasts.
- ◆ The budgeting and Estimates requirements of the *Budget Transparency and Accountability Act* (BTAA) and *Balanced Budget and Ministerial Accountability Act* (BBMAA) were met.

KEY FINDINGS AND RECOMMENDATIONS

REASONABLENESS OF FORECASTS FOR OPERATING EXPENSE, CAPITAL SPENDING AND DEBT

TO EXAMINE THE reasonableness of the forecasts for operating expense, capital spending and debt in the 2015/16–2017/18 Budget and Fiscal Plan, we assessed whether key assumptions used in preparing the forecasts:

- ◆ were suitably supported
- ◆ reflected expected economic conditions appropriately
- ◆ were consistent with government's plans
- ◆ provided a reasonable basis for the forecasts

We also examined whether the forecasts accurately reflected the underlying assumptions. To do this, we assessed whether the forecasts:

- ◆ were prepared using the same accounting policies used to prepare the Summary Financial Statements
- ◆ were accurately consolidated and compiled

Operating expense and capital spending budgets are prepared by each ministry based on direction from the Minister of Finance and Treasury Board. The ministries also coordinate compiling the budget

for those service delivery agencies under their responsibility.

To assess whether the operating expense and capital spending forecasts were reasonable, we examined details supporting the forecasts for a sample of ministries. We chose six ministries based on factors such as size of the ministry budget, the historical differences between budget and actual results, and our assessment of risk factors associated with the programs delivered.

Core government uses *incremental budgeting* for its annual operating expense. Most ministries received a status quo operating expense budget with an adjustment to fund its costs for the economic stability mandate (see topic box on [page 41 of the Budget and Fiscal Plan](#)). In addition, government provided budget increases to fund cost pressures in certain ministries (Health, Education, and some driven by their caseloads, such as Social Development and Social Innovation).

INCREMENTAL BUDGETING

This is a common approach to budget preparation that starts with the prior-year (base) budget, then makes small, targeted increases or decreases to funding for the coming fiscal year. The benefit of this approach is its simplicity. It is based on an assumption of stable, consistent patterns of expenses.

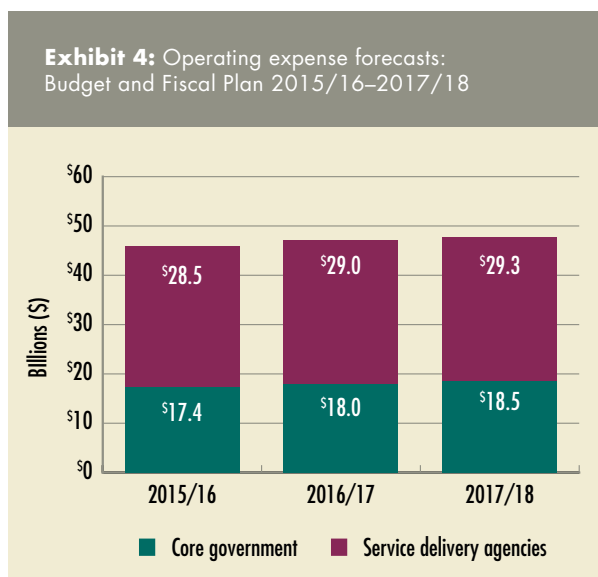
KEY FINDINGS AND RECOMMENDATIONS

Operating expense forecasts

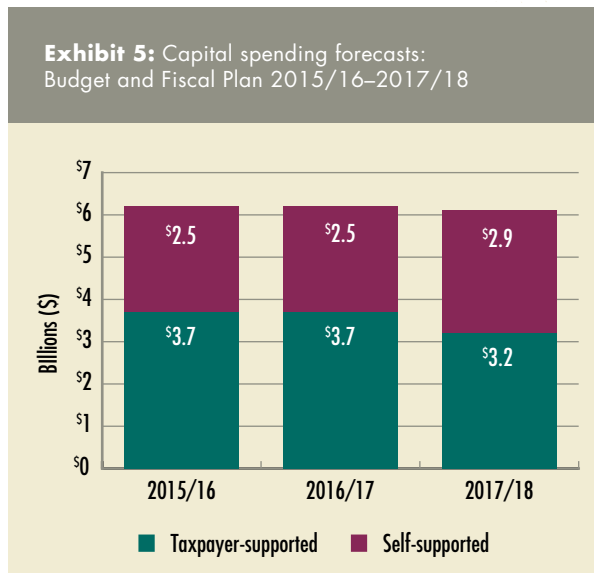
Operating expense forecasts in the Budget and Fiscal Plan are included in [Table 1.8 – Expense by Ministry, Program and Agency](#).

We concluded that the use of incremental budgeting is a reasonable approach, given government’s stable and consistent pattern of expenses. We also concluded that operating expense forecasts were reasonably supported – basing this finding largely on our observation that ministries have historically shown that they can deliver their programs within their annual funding (voted) allocations.

We did not examine whether the budget was sufficient to meet the demands of each government program, because there are programs where demand exceeds supply (such as health care) and ministries are required to manage within their fiscal targets.



Source: Compiled by the Office of the Auditor General of British Columbia, based on Budget and Fiscal Plan 2015/16–2017/18



Source: Compiled by the Office of the Auditor General of British Columbia, based on Budget and Fiscal Plan 2015/16–2017/18

Capital spending forecasts

Every ministry prepares its capital spending forecasts using a coordinated approach, though there are some differences depending on the ministry. In particular, the ministries of Education, Advanced Education and Health (collectively referred to as SUCH ministries given their responsibility for school districts, universities, colleges and health organizations) may receive annual multi-year capital plans from their respective service delivery agencies, based on individual agency needs. In addition, SUCH ministries and other ministries with large capital programs, including the Ministries of Transportation and Infrastructure, and Technology, Innovation and Citizens’ Services, maintain 10-year capital plans that are assessed and updated annually and submitted to Treasury Board Staff. Treasury Board Staff also reviews updated annual capital spending forecasts, including emerging capital needs, from other core ministries. Treasury Board Staff compile an annual consolidated capital plan for approval by Treasury Board.

KEY FINDINGS AND RECOMMENDATIONS

Capital spending is constrained by government's affordability framework, including the stated objective of maintaining a AAA credit rating.

Capital spending forecasts in the Budget and Fiscal Plan are included in [Table 1.14 – Capital Spending](#).

We concluded that the capital spending forecasts in Budget and Fiscal Plan 2015/16 – 2017/18 were reasonable.

Debt forecast

The Ministry of Finance prepares the debt forecast based on assumptions related to the government's consolidated cash flow. The cash flow amount includes the projected annual surplus, cash required to pay for capital projects, and expected changes in operating cash balances over the year.

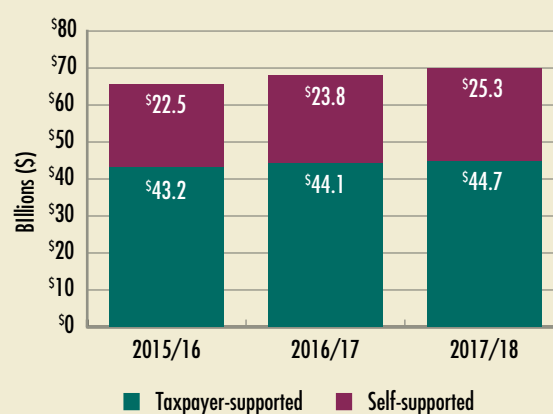
Debt forecasts in the Budget and Fiscal Plan are included in [Table 1.17 – Provincial Debt Summary](#).

We concluded that the debt forecasts in Budget and Fiscal Plan 2015/16–2017/18 were reasonable.

We compared the significant accounting policies used in preparing the forecasts for operating expense, capital spending and debt with those used in the preparation of the government's Summary Financial Statements, and found that they were prepared on a consistent basis.

Finally, we examined the compilation and consolidation process for the forecasts of operating expense, capital spending and debt in the Budget and Fiscal Plan. As part of our examination of sample ministries, we tested the compilation process for service delivery agency operating expense and capital forecasts. We also examined the Ministry of Finance's overall compilation and consolidation processes. We concluded that Budget and Fiscal Plan 2015/16–2017/18 was accurately compiled and consolidated.

Exhibit 6: Debt forecasts:
Budget and Fiscal Plan 2015/16–2017/18



Source: Compiled by the Office of the Auditor General of British Columbia, based on Budget and Fiscal Plan 2015/16–2017/18

In summary, we determined that government's forecasts for operating expense, capital spending and debt in Budget and Fiscal Plan 2015/16–2017/18 were based on sound processes and had been accurately compiled.

KEY FINDINGS AND RECOMMENDATIONS

CLARITY OF PRESENTATION AND DISCLOSURE IN THE BUDGET AND FISCAL PLAN

To determine whether the presentation and disclosure of the Budget and Fiscal Plan was consistent with general principles established in Canadian accounting standards for future-oriented financial information, we assessed whether government:

- ◆ used a presentation format that allowed for a comparison with government's Summary Financial Statements
- ◆ met the general disclosure requirements set out in the CPA Canada standards
- ◆ disclosed significant assumptions, including associated risks and sensitivities

Comparison with the Summary Financial Statements

Consistency in reporting between the Budget and Fiscal Plan and the Summary Financial Statements is important so that readers can compare government's planned and actual financial performance.

We found that the presentation of the forecasts for operating expense, capital spending and debt in the Budget and Fiscal Plan does enable comparison with the actual results in the Summary Financial Statements. Detailed tables at the back of the Budget and Fiscal Plan include pro-forma financial statements that allow for comparison with the Summary Financial Statements.

However, we did identify one area where the presentation of debt forecasts in the main body of the Budget and Fiscal Plan is not presented in accordance with the accounting policies used in the Summary Financial Statements. Those forecasts are reduced by the amount of investments held in sinking funds, and include guaranteed and non-guaranteed debt. [Table A15](#), an appendix in the Budget and Fiscal Plan, adjusts for these differences to come up with debt forecasts based on the Summary Financial Statements. The debt forecasts are presented this way to be consistent with the [Public Account's Debt Summary Report](#) – which is used by credit rating agencies in their credit opinion assessments of the Province.

SINKING FUNDS

Some of the Province of B.C.'s debt issues require government to set aside money, based on a schedule in the debt agreement, to pay off the debt when it matures. These earmarked funds (investments) are called sinking funds.

Although we agree that government's presentation of the debt forecasts in the main body of the Budget and Fiscal Plan is reasonable, there's a risk that readers may think the amounts are comparable with the debt balances in the Summary Financial Statements. A footnote to [Table 1.17](#) of the Budget and Fiscal Plan highlights the treatment of sinking funds, but no details are given to put this disclosure into context.

Presentation could be improved by government: clearly recognizing and explaining why the debt forecasts in the main body of the plan are not

KEY FINDINGS AND RECOMMENDATIONS

consistent with the Summary Financial Statements; and providing a link to Table A15 (on page 124) to enable readers to understand the difference (\$188 million for the 2015/16 debt forecast).

RECOMMENDATION 1: *We recommend that the Ministry of Finance inform readers of the reasons for, and effects of, using a different presentation for the debt balances in the main chapter of the Budget and Fiscal Plan than for the debt balances in the Summary Financial Statements.*

General disclosure requirements

Budgets are forward-looking documents that provide economic and fiscal forecasts based on a series of assumptions. In keeping with CPA Canada standards, expected disclosures for future-oriented financial information must include an explanation of the inherent limitations of future-oriented financial information so that readers can clearly understand implications and risks before making their own assessments based on the forecast documents.

In our examination, we found that most of the expected disclosures set out in the CPA Canada standards were included in the 2015/16–2017/18 Budget and Fiscal Plan. One gap was the lack of a clear statement of the risks associated with future-oriented financial information. However, we see that government has since included such a statement in the 2016/17–2018/19 Budget and Fiscal Plan.

Disclosure of significant assumptions

We examined the disclosure of significant assumptions to determine whether the information in the Budget and Fiscal Plan enabled readers to understand both the risks associated with the forecast and the potential impacts on the forecasted results.

[Table A7](#), an appendix in the Budget and Fiscal Plan, provides detailed information on the key assumptions for the operating expenses of significant ministry programs. That information includes four years of key assumptions data and a sensitivity analysis column for the 2015/16 forecasts. Disclosing these sensitivities informs readers about estimated changes in the expense forecasts resulting from changes in the key assumptions.

SENSITIVITY ANALYSIS

A technique used to measure the impact on an estimate from a change in one or more key assumptions.

There is no appendix summarizing the key forecast assumptions for capital spending. However, we found enough information in the main body of the Budget and Fiscal Plan to inform readers of the significant assumptions and sensitivities underlying the capital spending forecasts. The Ministry of Finance also discloses debt and interest rates as key sensitivities that can impact the fiscal plan as well as assumptions related to the management of public funds and debt.

KEY FINDINGS AND RECOMMENDATIONS

We concluded that the current level of disclosure gives readers a good basis from which to assess the risks associated with the forecasts of operating expense, capital spending and debt. At the same time, we also noted two main areas where government could enhance the disclosures.

1. Cost pressures at the beginning of the budget year

– The disclosure of the Contingencies vote and forecast allowance in the Budget and Fiscal Plan is intended to give readers a sense of how much caution government has built into the forecasts. During our examination, we identified two examples of where government knew of potential cost pressures at the beginning of the budget year. However, it was unclear how government had considered these pressures, and their impacts on the fiscal plan.

- ◆ **Direct fire-fighting costs:** The 2015/16 budgeted allocation for direct fire-fighting costs (in the Ministry of Forests, Lands and Natural Resource Operations voted appropriation) was \$63 million. The average annual cost for direct fire-fighting in the previous six years before Budget and Fiscal Plan 2015/16-2017/18 was \$200 million. This includes a low of \$54 million and a high of \$382 million. Funding of actual costs that exceed the budget allocation are authorized through statutory appropriations. There was no discussion in the Budget and Fiscal Plan about whether this likely statutory spending pressure influenced the amount of prudence built into the fiscal plan.

- ◆ **Contingencies vote allocations:** As part of the budgeting process, certain potential cost pressures in ministry forecasts were notionally allocated to the Contingencies vote at the beginning of the budget year. There was no discussion in the Budget and Fiscal Plan about these potential cost pressures. Because the Contingencies vote is one of the levels of prudence in the budget (as noted before), these potential cost pressures impact the amount of prudence built into the budget to accommodate unforeseen expenses or events during the year.

We concluded that the 2015/16–2017/18 Budget and Fiscal Plan could have provided readers with more information about the effect these potential cost pressures might have on government’s disclosed level of prudence. We noted, however, that the 2016/17–2018/19 Budget and Fiscal Plan, released before we completed this examination, does include improved disclosure ([page 42](#)) on prudence and risk. This addresses any recommendation we would have made.

2. Material assumptions for statutory caseload programs

– The Ministry of Social Development and Social Innovation delivers several caseload-driven programs, including Temporary Assistance and Disability Assistance. For these programs, eligibility is based on claimants meeting requirements set out in legislation. Government has limited control over the number of eligible recipients in the absence of policy and legislative changes. In our examination of the material assumptions in [Table A7](#), an appendix in the Budget and Fiscal Plan, we identified an 18% drop in Temporary

KEY FINDINGS AND RECOMMENDATIONS

Assistance caseload numbers, down from the 2014/15 updated forecast to the third year of the plan.

We would have expected the Budget and Fiscal Plan to include an explanation of how significant changes in caseloads were forecast (for example, based on information about the key assumptions or likely causes of the trends), along with any associated risks with the forecast. However, there were limited details to explain the significant changes in the caseload forecasts.

RECOMMENDATION 2: *We recommend that the Ministry of Finance enhance disclosure of the key assumptions supporting significant changes in projected caseload trends for statutory programs, to allow readers to understand the reasons and risks behind the changes.*

COMPLIANCE WITH LEGISLATION

To examine whether the budgeting and Estimates requirements of the *Budget Transparency and Accountability Act* (BTAA) and the *Balanced Budget and Ministerial Accountability Act* (BBMAA) were met, we assessed whether:

- ◆ all required consultations occurred
- ◆ the economic and fiscal forecasts and the Estimates were prepared in accordance with the BTAA
- ◆ all documents and disclosures required by the BTAA were provided
- ◆ the Estimates did not forecast a deficit, as required by the BBMAA

Our examination focused on the parts of the acts related to the forecasting of operating expense, capital spending and debt in the 2015/16–2017/18 Budget and Fiscal Plan and the 2015/16 Estimates.

We concluded that the budgeting and Estimates requirements of both acts were met.

PHASE 1 FOLLOW-UP

BELOW IS AN UPDATE on the three recommendations we made in our June 2015 report, *Budget Process Examination Phase 1: Revenue*, concerning the economic and revenue forecast process in Budget and Fiscal Plan 2014/15–2016/17.

We are pleased to report that the Ministry of Finance has addressed all three of the recommendations.

- ◆ The first recommendation was for the ministry to clearly disclose in the Budget and Fiscal Plan the inherent limitations associated with future-oriented financial information, in line with the disclosure standards established by CPA Canada. The ministry included these recommended disclosures in the 2016/17 Budget and Fiscal Plan.
- ◆ The second recommendation was for the ministry to enhance its sensitivity disclosures in appendix Table A5 of the Budget and Fiscal Plan, explaining why the selected economic variables are used, and disclosing and discussing the likely range of historical data volatility. In response to this recommendation, the ministry has added a detailed discussion of data volatility for key economic variables in its [2016 Financial and Economic Review](#). To close the loop on this recommendation, the ministry has provided additional discussion in the 2017/18 Budget and Fiscal Plan about why these economic variables are included as major assumptions in the budget.
- ◆ The third recommendation was for the ministry to provide additional information about the risks supporting the annual forecast allowance. The recommended information was included in the 2016/17 Budget and Fiscal Plan.

APPENDIX A: MILESTONES IN THE BUDGET CYCLE FOR BUDGET AND FISCAL PLAN 2015/16–2017/18

Key milestones in the budget cycle for Budget and Fiscal Plan 2015/16–2017/18	
September 2014	Budget consultation paper released (by September 15) Capital budget instructions sent to ministries
October–December 2014	Treasury Board reviews spending requests
November 2014	A Select Standing Committee reports on public consultations (by November 15)
December 2014	Economic Forecast Council surveyed
December 2014	Preliminary economic assumptions and forecasts prepared
December 2014–January 2015	Treasury Board makes operating expense and capital spending budget decisions
January 2015	Economic Forecast Council re-surveyed Economic assumptions and forecasts finalized Operating expense, capital spending and debt forecasts finalized Budget and Fiscal Plan prepared
February 2015	Budget and Fiscal Plan completed Budget and Fiscal Plan tabled in the Legislature (February 17, 2015)

Accountability reporting after the release of the Budget and Fiscal Plan	
September 2015	Q1 Update
November 2015	Q2 Update
February 2016	Q3 Update (component of the next year Budget and Fiscal Plan)
July 2016	Summary Financial Statements (actual results for fiscal 2015/16)
August 2016	Financial and Economic Review (for fiscal 2015/16)



OFFICE OF THE
Auditor General
of British Columbia

Location

623 Fort Street
Victoria, British Columbia
Canada V8W 1G1

Office Hours

Monday to Friday
8:30 am – 4:30 pm

Telephone: 250-419-6100

Toll free through Enquiry BC at: 1-800-663-7867

In Vancouver dial: 604-660-2421

Fax: 250-387-1230

Email: bcauditor@bcauditor.com

Website: www.bcauditor.com

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AUDIT TEAM

Sheila Dodds,
Assistant Auditor General

Bill Gilhooly,
Assistant Auditor General

Bob Faulkner,
Director

Spencer Goodson,
Manager

Paul Lewkowich,
Manager

Tommy Chung,
Senior Audit Associate

Ruby Wu,
Senior Audit Associate



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