AUDITOR GENERAL

1994/95: Report 3

Report on the 1993/94 Public Accounts

Province of British Columbia

Report on the 1993/94 Public Accounts, Province of British Columbia

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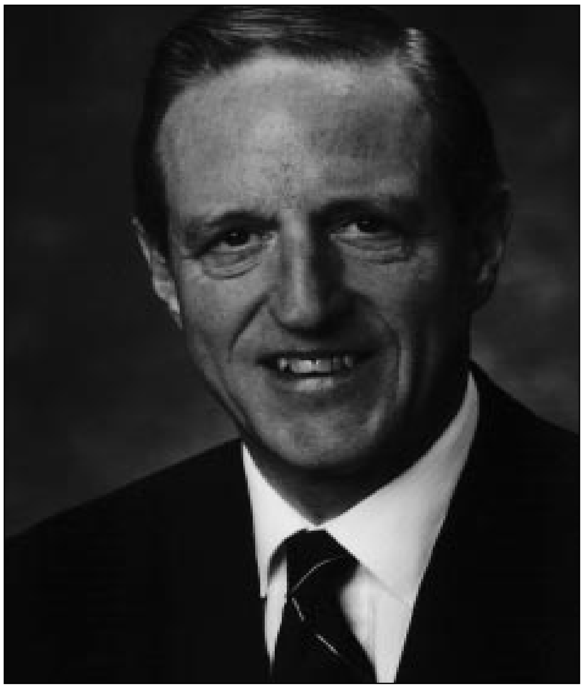


The annual Public Accounts of the Province of British Columbia and the companion Public Accounts Digest may be the most important accountability documents produced by the government. They detail what taxes and other revenues were collected by the government and how that money was spent.

Because of the attention given by legislators and the public to the content of the Public Accounts upon their issuance I believe it essential that, as Auditor General for the province, I provide on a timely basis my comments on the content of those documents. My Office examines the Public Accounts from a variety of perspectives—fairness and accuracy, appropriateness, completeness, consistency, timeliness—and I then report our findings to the Legislative Assembly and the public. This is my report on the recently published Public Accounts for the 1993/94 fiscal year.

Timeliness of the Public Accounts

Prior to 1991, the province's annual Public Accounts were not made public until they were tabled in the Legislative Assembly. Usually tabling took place some 12 months or so after the end of the fiscal year being reported on—a most untimely release of important financial information.

Now the government is releasing the Public Accounts as soon as they are available, prior to their being tabled in the legislature. This action I applaud. However, as the availability date is still more than eight months after the fiscal yearend, true timeliness in the release of these publications has yet to be realized. I continue to encourage the government to strive for the completion and issuance of the Public Accounts on a much more timely basis than has so far been achieved.

Ongoing Issues of Importance

In my report on the Public Accounts for the 1992/93 fiscal year, I identified three financial accountability issues of particular importance.

The first concerned the recording, as assets of the province, of some $3.6 billion in loans receivable that can only be recovered from future public funding to the loan recipients. Although in the 1993/94 financial statements these loans continue to be recorded as assets, they have been recategorized so that they are no longer reported as "financial assets" available to discharge the province's liabilities. As a consequence, assets considered to be financial assets, and the extent to which they meet the province's liabilities, are disclosed in the province's Statement of Financial Position as at March 31, 1994.

The second issue related to the existence of $3.3 billion of unfunded liabilities of public sector pension plans. Responsibility for these liabilities had not been acknowledged by any parties associated with the plans, nor were any policies or programs in place to limit or reduce these unfunded amounts. During the 1993/94 fiscal year, the Legislative Assembly passed a Bill, provisions of which have the effect of capping any increase in the unfunded liability of these plans, calculated as a percentage of plan member payroll. However, the determination of who is responsible for unfunded pension plan liabilities still remains unresolved.

The third issue pertained to the need for government to report the full extent of its activities and financial position in a more meaningful way—in a way that would more accurately capture full program costs on a fiscal year basis. On this matter, the government is currently studying the implications of a policy of capitalizing and amortizing physical assets as compared to the current policy of expensing capital costs as they are incurred. Included in that study is a reconsideration of which organizations should be included in the government's Summary Financial Statements, and how the results of their operations should be combined into the summary statements. I am hopeful that this study will address my concerns about the present form and content of the government's summary statements.

Better Public Reporting

My Office works with government to help improve its financial accountability. In this regard, I have discussed with government officials many important issues that have come to my attention during my audits of the province's financial statements. A number of these issues, included in this report, have not been resolved satisfactorily.

I continue to urge the government to use information extracted from the Summary Financial Statements when providing public comment on the results of its operations. Financial information that is based on transactions in the Consolidated Revenue Fund provides incomplete, and potentially misleading, information as to the full extent of government activities.

In this report I have pointed out that, with the recent formation of the British Columbia Transportation Financing Authority, highway and bridge construction activities will no longer be fully recorded in the Consolidated Revenue Fund Financial Statements. As a result, the usefulness of these statements for accounting for government activities will be further diminished because they are incomplete and not comparable to earlier years. These activities will, however, continue to be included in the Summary Financial Statements.

Again this year I have included in my report separate sections on public debt and financial highlights, as I believe information in these sections leads to a better public understanding of the government's current financial position, and provides a basis for a more informed review of government program options and decisions.

I have also reported the results of reviews by my Office of government processes and procedures relating to $1.5 billion of contributions and grants made to non–government organizations and $1.5 billion of payments made under the B.C. Medical Services Plan.

Included with my report on payments to non–government organizations is a companion review of final payments made under the "Breakopen" program administered by the B.C. Lotteries Corporation. This program is one that I have commented on previously.

Both these reviews relating to non–government organizations clearly indicate that the government should do far more to assess and monitor the use of funds paid to non–government organizations under these programs.

My assessment of controls over the claims payment systems of the Medical Services Plan is that these systems are operating reasonably adequately, considering the government becomes informed of its liability only after the services have been rendered to MSP beneficiaries. This working environment presents a challenge for the B.C. Medical Services Commission, which continues to seek improvements in its control systems.

I believe that this report will provide legislators and the public with valuable opinions and findings on a variety of matters relating to British Columbia's Public Accounts for the 1993/94 fiscal year.

This is my third report for 1994/95. The first two, issued in September 1994, related to value–for–money audits undertaken by my Office. One was an audit of the purchasing of goods in school districts and the other an audit of the role of the Provincial Agricultural Land Commission.

I wish to acknowledge the outstanding work carried out by my staff, which has resulted in the issuance of these reports, and to thank them for their professionalism and dedication.

George L. Morfitt, FCA
Auditor General

Victoria, British Columbia
December 1994

Introduction

The Auditor General is required, under the provisions of the *Auditor General Act*, to examine the accounts and records of the government and to report annually to the Legislative Assembly on the government financial statements. In these reports, the Auditor General must state whether all the information and explanations required have been received, and whether the statements present fairly the financial position, results of operation, and changes in financial position of the government in accordance with its stated accounting policies, consistently applied. If the Auditor General is unable to express an opinion without reservation, the reason why should be stated.

The Auditor General is also eligible to be appointed auditor of any Crown corporation, Crown agency, or public body. The Act does not specify what is required of the Auditor General in the conduct of such audits. In the absence of special direction, the work is carried out in a manner and with the same objectives as those applied to the audit of the government's accounts.

The Auditor General may call attention to anything resulting from his or her examination that he or she considers should be brought to the attention of the Legislative Assembly. The Act directs that the Auditor General should comment where he or she believes that accounting records are not sufficient or properly kept or that internal controls are not adequate to protect the assets of the Crown, the collection of revenue, or the making of expenditures. He or she may also provide an assessment as to whether the financial statements of the government are prepared in accordance with the most appropriate basis of accounting for the purpose of fair presentation and disclosure.

The Auditor General's mandate provides for comment on whether government programs are being administered economically and efficiently, and whether there has been compliance with laws and regulations. The Auditor General reports separately on these matters in value–for–money and compliance–with–authorities audit reports.

This report contains comments and observations arising from work undertaken in the Auditor General's audit of the financial statements of the government for the fiscal year ended March 31, 1994. It also relates to audits of the financial statements of various Crown corporations and other public bodies, in particular those for which the Auditor General is the appointed auditor.

Government Financial Statements and Public Accounts

The government financial statements are an important link in an essential chain of public accountability. They are the principal means by which the government reports to the Legislative Assembly, and to all British Columbians, on its stewardship of public funds.

Public Accounts

The Public Accounts, prepared pursuant to the *Financial Administration Act,* contain the financial statements and other information that the government is required or chooses to include in the publication. The form and content of the Public Accounts, as well as the accounting policies used in the preparation of the financial statements, are determined by Treasury Board.

The Public Accounts for the 1993/94 fiscal year are published in two volumes.

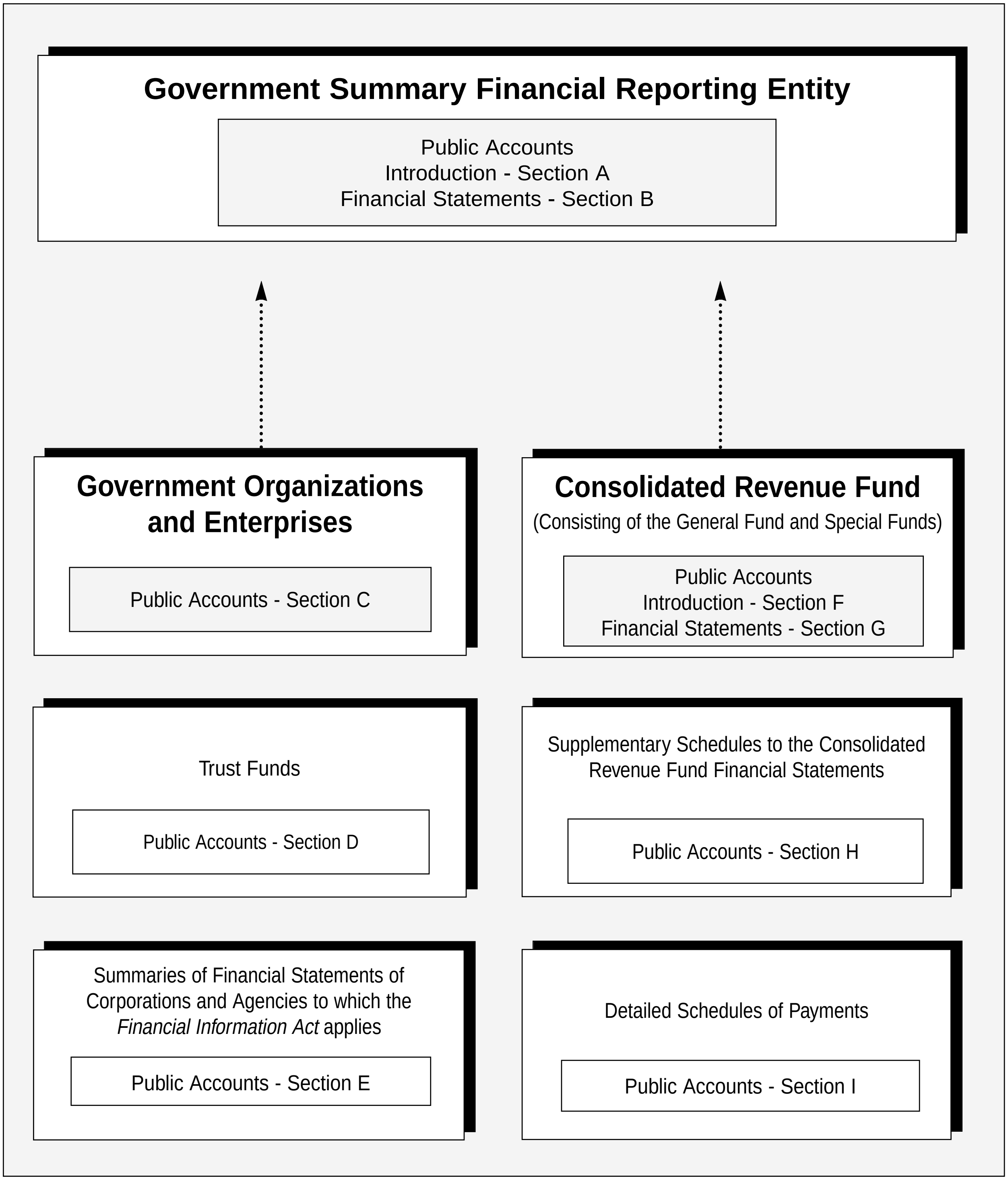
Volume I (Sections A to E), titled *Consolidated Reporting Entity, Trust Funds and Summaries of Financial Information Reports,* provides an overview of the total financial affairs and resources for which the government is responsible. It contains the government Summary Financial Statements, the latest audited financial statements of government organizations and enterprises and of certain trust funds administered by the government, and summarized financial information of corporations and entities to which the *Financial Information Act* applies.

Volume II (Sections F to I), titled *Financial Statements and Schedules of the Consolidated Revenue Fund,* contains the audited financial statements of the Consolidated Revenue Fund, together with supplementary schedules to the financial statements and detailed schedules of payments. This volume is intended to serve as the government's accountability report to the legislature on revenues raised and expenditures made as authorized by the *Supply Act* and other statutory spending authorities.

The structure of the government's financial reporting in the Public Accounts is outlined in Exhibit 1.1.

Exhibit 1.1

Financial Reporting in the Public Accounts



Source: The Public Accounts

Summary Financial Statements

The Summary Financial Statements provide the most complete information about the operating results and financial position of the Province of British Columbia. They aggregate most, but currently not all, entities owned or controlled by the province by combining the financial position and results of operation of the province's general and special funds, collectively referred to as the Consolidated Revenue Fund, with the financial position and operating results of the government entities listed on page B27 of Appendix D of this report.

A copy of the Summary Financial Statements, together with the Auditor General's report on them, appears in Appendix D of this report.

Depending on the nature of their operations, these aggregated entities are referred to as either "government organizations" or "government enterprises." In addition to the Consolidated Revenue Fund, government organizations include associations, societies, and entities which are separated from the operation of central government mainly for administrative reasons. Government enterprises, on the other hand, are usually business–oriented entities whose primary customers are not government related.

The account balances of government organizations are fully consolidated with the central government's accounts on a line–by–line basis after they are adjusted for compliance with the government's stated accounting policies. Government enterprises are consolidated on a modified equity basis. This means that the original cost of investment of the government in these business enterprises is adjusted each year to include the net earnings or losses and other net equity changes of each enterprise. These enterprises follow accounting policies generally accepted for commercial operations.

The government, in its summary financial statements, reports the cost of capital assets and consumable inventories as expenditure in the fiscal year they are acquired, rather than in the years in which they are consumed or in which the benefits from their acquisition are realized. This means that the assets recorded in the summary financial statements at March 31, 1994, do not include the cost of land (except land for lease or resale), roads and bridges, buildings, equipment, fixtures, and furniture owned by the province.

Consolidated Revenue Fund Financial Statements

Next in order of completeness are the financial statements of the Consolidated Revenue Fund. This fund, established in accordance with the *Financial Administration Act*, accounts for substantially all the financial activities of central government.

The Consolidated Revenue Fund is the fund into which all public money of the government, other than trust funds, must be paid. Accordingly, its financial statements also constitute an important accountability document. The Consolidated Revenue Fund Financial Statements include the accounts of the General Fund, British Columbia Endowment Fund, and the Natural Resource Community Fund. The Consolidated Revenue Fund Financial Statements are the only operating fund statements of the government on which the Auditor General provides an auditor's report.

The financial statements of the Consolidated Revenue Fund could be used mistakenly for reviewing the province's overall financial position and results of operation. To prevent any misunderstanding, the Auditor General's Report on the Consolidated Revenue Fund Financial Statements for the year ended March 31, 1994, contains this additional paragraph:

> *As described in note 1(a), these financial statements reflect only the transactions and balances of the Consolidated Revenue Fund, which consists of the General Fund and Special Funds. Other significant financial activities of the Government occur outside this reporting entity. These additional activities are reflected in the Summary Financial Statements of the Government, included in Volume I of the Public Accounts, which consolidate the transactions and balances of the Consolidated Revenue Fund with those of other Government organizations and enterprises to provide an accounting of substantially the full nature and extent of the financial affairs and resources for which the Government is responsible.*

To clarify the significant differences in financial results between the government summary financial reporting entity and the Consolidated Revenue Fund, relative financial results and balances for each of the past two fiscal years are shown in Exhibit 1.2.

Exhibit 1.2

Comparative Summary of Financial Results and Balances

($ Millions)

	Summary Financial Reporting Entity		Consolidated Revenue Fund	
	1993/94	1992/93	1993/94	1992/93
Liabilities, end of year:				
Public debt	22,738	19,835	21,582	18,458
Other	3,140	2,896	3,010	2,733
	25,878	22,731	24,592	21,191
Financial assets, end of year	13,933	12,342	11,849	10,212
Net liabilities, end of year	11,945	10,389	12,743	10,979
Net expenditure for the year	904	1,547	915	1,693
Guaranteed debt, end of year	3,042	3,429	4,183	4,814

Source: The Public Accounts

Special Funds

British Columbia Endowment Fund

A special fund, the British Columbia Endowment Fund, was established on April 1, 1992, under the *British Columbia Endowment Fund Act,* at which time the balance of the Privatization Benefits Fund was transferred to it. As with its predecessor, its purpose has been to hold the assets of this fund in perpetuity and keep them invested to produce revenue for the economic benefit of British Columbia. During the year, the Endowment Fund has received $37 million in realized investment gains, $33 million in interest from investments, and $2 million in net proceeds from the disposition of assets. The market value of net assets of the fund at March 31, 1994, was $731 million (cost $671 million).

On April 1, 1994, the shares of Discovery Enterprise Inc. were transferred from the General Fund to the Endowment Fund. The market value of these shares was $20 million. On June 2, 1994, the *British Columbia Endowment Fund Act* was repealed and the Endowment Fund was closed. Of the fund’s assets, $44 million was set aside in an investment account referred to as the

British Columbia Focus Fund, for investing in British Columbia businesses. The government has stated that remaining proceeds from winding up the British Columbia Endowment Fund are to be used to pay off government debt.

Natural Resource Community Fund

Effective April 1, 1992, the Natural Resource Community Fund was established under the *Natural Resource Community Fund Act*. This Special Fund was established to assist communities largely dependent on a single resource industry to adjust to severe economic declines that result in business closures.

This fund receives as income 0.5% of all revenues, other than fines, collected under a number of acts dealing with natural resources. Its value is not to exceed $25 million. During the 1993/94 fiscal year, the fund received $7 million from natural resource revenues and earned $1 million in interest. In the same period, it provided $2 million in assistance to eligible communities and transferred $2 million back to the General Fund. The balance of the Natural Resource Community Fund as at March 31, 1994, stood at the $25 million limit.

The Auditor General's Reports Resulting from Financial Statement Audits

Auditor's Reports on Financial Statements

As a result of the examinations carried out, the Auditor General has provided auditor's reports on the Summary Financial Statements and the Consolidated Revenue Fund Financial Statements prepared by the government for the fiscal year ended March 31, 1994, and on the financial statements of 49 government entities (including 12 government organizations and enterprises and 37 other government entities) whose fiscal yearends occurred on that date or during that fiscal year.

The Auditor General's reports on the Summary Financial Statements and the Consolidated Revenue Fund Financial Statements for the fiscal year ended March 31, 1994, were issued without a reservation, or qualification, as to the fair presentation of those statements. They appear with the respective statements published in the Public Accounts. Reports containing the Auditor General's opinions on financial statements of government entities are similarly appended to the statements of each entity.

The Auditor General reports in the format of the standard auditor's report recommended by the Canadian Institute of Chartered Accountants (CICA). The wording adopted by the CICA emphasizes the role of management and the auditor with respect to the statements.

The recommended report contains three paragraphs. The first identifies the financial statements that have been audited, and points out that management is responsible for preparing those statements and the auditor for expressing an opinion on them. Next is a paragraph which describes the nature and extent of the auditor's work and the degree of assurance that the auditor's report provides. It refers to generally accepted auditing standards and describes some of the important procedures the auditor undertakes. The final paragraph contains the auditor's conclusion based on the audit conducted.

Further comments on the significance of the auditor's opinion, and on the process employed in reaching that opinion, appear in Appendix A of this report.

Other Reports

While conducting our financial statement audits, we encounter numerous items that call for study and corrective action by the ministries, central agencies, and government entities concerned. We deal with these matters by contacting officials of these organizations directly. Some issues, however, are considered of sufficient significance to warrant the attention of the Legislative Assembly and are included in this report. Those arising as a result of our audit of the government financial statements appear in a section of this report titled, "Audit of the Government Financial Statements." Those relating to our audit of government entities are contained in another section titled, "Audit of Financial Statements of Government Entities, Trust Funds, and Other Organizations."

Audit of the Government Financial Statements

Changes in the Government Reporting Entity

The accounting policies used to prepare the Summary Financial Statements define what should be included in the government reporting entity. The statements are intended to include all organizations that are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the legislature, and that are owned or controlled by the government.

A detailed schedule of organizations and enterprises included in the government reporting entity is shown in Appendix D, on page B27.

Changes to the composition of the government reporting entity during the 1993/94 fiscal year are discussed on page 157 of this report in a section titled, "Audit of Financial Statements of Government Entities, Trust Funds and Other Organizations." In summary:

- The B.C. Transportation Financing Authority and the Pacific Racing Association were created during the year and added to the entity.
- The British Columbia Rapid Transit Company Ltd. was added to the entity.
- The Hospitals Foundation of British Columbia was removed from the entity.
- Four government organizations dissolved during the 1993/94 fiscal year were removed from the entity. These were: the Plain Language Institute of British Columbia Society, The Education Technology Centre of British Columbia, the 178561 B.C. Ltd., and the British Columbia Hazardous Waste Management Corporation.
- The Cloverdale Historic Transportation Society of B.C., which ceased operations during the 1992/93 fiscal year, was removed from the entity this year.

In past years we have commented that in our view the government needed to include a number of additional government organizations in the reporting entity if it was to conform to its own accounting policies. These polices are consistent with those established by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants (CICA). The board itself is currently re–examining its criteria for determining what organizations should be included in the government reporting entity.

The government also has activities currently under way which would affect the composition of the government reporting entity. It has undertaken to study whether capital assets should be included in the government financial statements.

The composition of the reporting entity was also discussed by the Public Accounts Committee in March 1994. The committee recommended that the Auditor General and Comptroller General work towards resolving the issue of what should be included in the financial reporting entity for the purpose of preparing the province's financial statements.

We have commented on some of these issues and expressed our views as to the composition of the government reporting entity, on page 38 of this report. There we have also commented on the government's commitment to examine with us, during the 1994/95 fiscal year, the question of what should or should not be included in the reporting entity.

Amounts Recoverable Only Through Future Government Funding

In our previous reports on the government's annual Public Accounts, we discussed the loans made to public sector organizations through the Fiscal Agency Loan Program and included as assets in the financial statements of the government. We recommended that those loans which are expected to be recovered only through future government appropriations be reduced in value, through the establishment of valuation allowances, to the amounts estimated to be realizable from sources outside the government reporting entity.

We commented that the basis of accounting used in the preparation of the financial statements of the government is aimed at explaining the difference between liabilities and financial assets. Financial assets are assets on hand at the end of an accounting period which could provide resources to discharge existing liabilities or to finance future government operations. The loans made through the Fiscal Agency Loan Program, that are to be repaid in future from resources provided by the government itself, cannot be used either to discharge liabilities or to finance future operations. They should not, therefore, be considered financial assets of the government.

We are pleased to report that the government has significantly changed the way it reports these loans in its financial statements. For the first time in British Columbia, the government has clearly indicated its net liabilities in the financial statements. It has done this by recognizing that some of the loans made through its Fiscal Agency Loan Program are not financial assets.

"Net liabilities" is a key indicator of the province's financial position because it represents the shortfall of assets available to meet current obligations. These obligations must then be financed through future revenue.

The changes made by the government can best be shown in Exhibit 2.1 which compares the Balance Sheet, as reported in the

Exhibit 2.1

Presentation of the Financial Position of the Province

These two statements compare the way government used to report loans made through its Fiscal Agency Loan Program with how it reports them now ($ Millions)

Balance Sheet [(1)]
[As reported in the 1992/93 Public Accounts]

	March 31, 1993	March 31, 1994[(2)]
Assets		
Other assets	6,062	6,851
Fiscal Agency Loan Program	10,167	11,621
	16,229	18,472
Liabilities and Net Equity (Deficiency)		
Other liabilities	2,896	3,140
Public debt, used for government operating purposes	9,689	11,116
Public debt, used for Fiscal Agency Loan Program	10,146	11,622
	22,731	25,878
Net equity (deficiency)	(6,502)	(7,406)
	16,229	18,472

Statement of Financial Position[(1)]
[As reported in the 1993/94 Public Accounts]

	March 31, 1993[(2)]	March 31, 1994
Liabilities		
Other liabilities	2,896	3,140
Public debt, used for government operating purposes	9,689	11,116
Public debt, used for loans under the Fiscal Agency Loan Program:		
Recoverable through future appropriations	3,879	4,540
Recoverable from agencies	6,267	7,082
	22,731	25,878
Financial Assets		
Other financial assets	6,062	6,851
Loans for purchase of assets, recoverable from agencies	6,280	7,082
	12,342	13,933
Net liabilities	10,389	11,945
Loans for purchase of assets, recoverable through future appropriations	3,887	4,539
Net deficiency	6,502	7,406

(1) Condensed for comparison purposes
(2) Re–arranged for comparison purposes

Source: The Public Accounts

1992/93 Public Accounts, with the Statement of Financial Position, as reported in the 1993/94 Public Accounts. In its 1992/93 financial statements, the total value of loans made by the government through its Fiscal Agency Loan Program was classified as a financial asset. In its 1993/94 financial statements, the government has classified only loans recoverable from agencies through their own resources as financial assets. Loans recoverable through future government appropriations were disclosed in the statement after the province's total "net liabilities" were calculated. A similar change has been made to public debt used for the Fiscal Agency Loan Program.

We are still concerned that under the government's current basis of accounting, loans made to government organizations and recoverable from future appropriations are being shown as assets, albeit not financial assets, in the government's financial statements. The government has assured us that it is addressing this issue in its study examining whether capital assets should be included in the financial statements, and what organizations should be included in the government's financial statements.

Pension Liabilities

Public Service Superannuation Plan Liability

In last year's report we applauded the government for including in its financial statements the unfunded liability of the Public Service Superannuation Plan, but were concerned about the appropriateness of the actuarial cost method used to calculate the liability. The method used by the government was the "level contribution method" and we believed that, as recommended by PSAAB, the "accrued benefit method" was the appropriate way to calculate the liability.

We are pleased to note that for this year's financial statements the government did adopt the accrued benefit method. However, the amount it recorded was based on the liability calculated as at March 31, 1993, the date of the last completed actuarial valuation, and no adjustment was made for any change in the liability during 1993/94 (as is recommended by PSAAB). Though we estimate the change in 1993/94 to be small, this change in liability in future years could be significant, in which case the difference should be recognized.

Liability for Pensions of the Members of the Legislative Assembly

In our reports to the Legislative Assembly for each of the years 1991–1994, we recommended that the government calculate its liability for the unfunded pension obligations of the Members of the Legislative Assembly according to the CICA recommendations. To date, the government has not acted on our recommendation.

In the 1991/92 fiscal year, the government recorded a $6.5 million liability as a rough estimate of the unfunded obligation. A rough estimate was used because the government does not believe that an actuarial valuation can provide a reasonable estimate of the liability. Because continuation of a Member's pensionable service often depends on election results rather than on the will of the Member, the government believes that historical information may not be a reasonable basis for predicting trends and making assumptions about turnover, eligibility, and retirement age.

For the 1993/94 fiscal year, the liability reported in the financial statements remains at $6.5 million. Unless the liability for pensions of the Members of the Legislative Assembly is determined by an actuarial valuation, we are unable to determine how reasonable this estimate might be.

Other Public Sector Statutory Pension Plans: Teachers', College, Municipal

The province maintains three other statutory pension plans—the Teachers' Pension Plan, the College Pension Plan, and the Municipal Superannuation Plan—for public sector employees working in entities that receive significant funding from the province. Under existing legislation for these plans, there are no provisions specifying who is responsible for funding any unfunded liabilities. The unfunded liabilities of these three plans, totalling approximately $3.6 billion[1] at March 31, 1994, are currently not being recorded in the financial statements of either the provincial government or the corresponding employer entities.

The government's current practice of not recognizing these unfunded pension liabilities is based on the fact that no provisions in the legislation for these plans hold the government responsible for them. However, neither are there provisions holding the employer entities responsible. This places British Columbia in a unique situation, since other provincial jurisdictions specify the responsibility for unfunded liabilities in their respective legislations.

British Columbia's position is not significantly different from that of the private sector, however, in those circumstances where employers are not committed contractually to fulfilling pension promises. The contemporary view in the private sector is to look through the legal requirements to the economic substance of pension obligations. That is, pension promises are an unavoidable commitment and there is a strong moral obligation—even if there is not a legal one—to honor pension claims. This view is consistent with professional accounting standards that specify that liabilities do not have to be legally enforceable but can be based on equitable (moral) or constructive (inferred from the facts) obligations.

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[1] According to the latest audited financial statements of the three plans, calculated by the accrued benefit method.

We believe, therefore, that liabilities do exist with respect to these unfunded pension promises. The question, then, is who should be recording the liabilities. In the private sector this is not an issue, because employers agree “voluntarily” to provide a pension plan for their employees. In the British Columbia public sector this agreement is not so clear. For example, school boards, as direct employers of their teachers, have made no pension agreements with them. In reality, it is the provincial government that has made the promise to the teachers, since it has determined through legislation the terms and conditions of the Teachers’ Pension Plan. These terms include which employers (and, consequently, employees) fall under the plan, what benefits are to be provided, and what contribution rates are required for funding purposes. In other words, the provincial government controls virtually all aspects of the Teachers’ Pension Plan. The same circumstance exists for the Municipal and College plans. Most direct employers have no choice but to follow the provisions as enacted by the province.

In our opinion, there is a strong case for treating a significant portion of the unfunded liabilities of the Teachers’, College, and Municipal plans as liabilities in the province’s financial statements. We consider this matter, the recording of the unfunded pension liabilities of these plans, to be an urgent financial reporting issue in need of corrective action by the government. The government has improved disclosure in this year’s financial statements by including information on these pension plans in a note, but we consider this to be an interim measure and continue to recommend that the government record these liabilities in its financial statements.

We recommend that the government record its obligations for pension liabilities of the Teachers’ Pension Plan, the College Pension Plan, and the Municipal Superannuation Plan in its financial statements.

Comments on Changes to Government Accounting Policies and Accounting Estimates

In reporting on the financial statements of the government, the *Auditor General Act* requires the Auditor General to say whether the statements present fairly the financial position and results of operations of the government in accordance with the government’s stated accounting policies. The Auditor General may also include, in a report to the legislature, comments on any accounting policy that is not suitable, or could be improved upon, for the purpose of fair presentation and disclosure.

The province’s stated accounting policies are described in note 1 of both the Summary and Consolidated Revenue Fund financial statements. These policies, and any changes to them, are authorized by Treasury Board, usually after extensive evaluation by the Office of the Comptroller General, Treasury Board staff, and financial officers throughout the government.

It is also often necessary, when preparing financial statements, to estimate certain incomes or expenditures when amounts are not yet known. As better information becomes available, the processes used to make these estimates may change. Changes in accounting estimates do not require similar approval as do changes in accounting policies.

Changes to government's accounting policies and accounting estimates, and their effects on the Summary Financial Statements, are described on page 26 of the Public Accounts. Our comments on these changes follow here.

Revenue Collected to Finance the B.C. Transportation Financing Authority Is Not Included in the Consolidated Revenue Fund

In 1993, the *Build BC Act* created a new Crown corporation, the B.C. Transportation Financing Authority (BCTFA). Its purpose is to plan, construct, and improve the transportation infrastructure throughout the province. The BCTFA is fully consolidated in the Summary Financial Statements.

The BCTFA is financed partly by a sales tax on car rental and a one–cent increase in the provincial gasoline tax. It has no independent taxing authority itself, but legislation authorizes the collection of these taxes within the Consolidated Revenue Fund. The taxes, collected by the Consolidated Revenue Fund and paid to the BCTFA, amounted to $35 million in the 1993/94 fiscal year.

A change in revenue accounting policy in the 1993/94 fiscal year was approved to accommodate the accounting for the $35 million. As a result of this change, the collection and transfer of these taxes are treated by the government as "financing transactions," and not as revenues and expenditures of the Consolidated Revenue Fund.

We believe that these taxes should properly be treated as revenue of the Consolidated Revenue Fund, and that the transfer of any funds to the BCTFA should be treated as an expenditure of the same fund.

The net result of the inappropriate accounting treatment in 1993/94 is that, in the financial statements of the Consolidated Revenue Fund, both taxation revenue and transportation expenditure for the year are understated by $35 million. Because these amounts offset each other, there is no apparent effect on the deficit for the year or the accumulated deficit at the yearend. Furthermore, because the BCTFA is included in the government reporting entity, there is no effect on the Summary Financial Statements.

We recommend that the government record the taxes collected and transferred to the BCTFA as both taxation revenue and transportation expenditure in the Consolidated Revenue Fund.

Accounting for Unfunded Pension Obligations Improved

Treasury Board approved a change in accounting policy for the unfunded pension liability of the Public Service Pension Plan. In prior years, the liability was calculated using the level contribution method. For the 1993/94 fiscal year, the accrued benefit method was used, as recommended by the PSAAB. This change is reflected in both the 1993/94 Summary and Consolidated Revenue Fund financial statements.

We concur with this change in accounting policy, as it better reflects the cost of pension benefits earned by employees up to the financial statement date.

Estimate of Personal Income Taxes and Established Program Financing Entitlements Improved

The federal government makes remittances to British Columbia throughout the year for personal income taxes it collects on behalf of the province, and for established program financing (EPF) entitlements. The latter relate to health and post–secondary education programs, and are calculated based on provincial population and personal and corporate tax revenue levels. In prior years, these remittances were calculated by the federal government on the basis of its estimates of the province's income tax revenue, and accounted for as revenue in the province's financial statements when the amounts were received from Canada.

For the 1993/94 fiscal year, with accurate information available early, the government was able to estimate the amount due from Canada for personal income taxes and EPF entitlements. This estimate is now included in the financial statements, which have been restated to show the comparable amounts for the 1992/93 fiscal year.

We support this change in accounting estimates, because it results in a more accurate reflection of revenue due to the province from these two sources.

Responsibilities for the Preparation of the Government Financial Statements Now Clearly Evidenced

The *Financial Administration Act* (FAA) assigns responsibility for the government financial statements. Treasury Board is responsible for determining the government's accounting policies and practices, including the format and content of the Public Accounts and Estimates, and therefore for deciding the framework for government's financial statements. The Comptroller General is responsible for preparing the financial statements within that framework.

Last year we commented to the Ministry of Finance and Corporate Relations on our concern that the officials acting as signatories to the government financial statements and statements of responsibility were not those who were required by FAA to evidence the assigned responsibilities.

We are pleased to note this year that the Minister of Finance and Corporate Relations, as the Chair of Treasury Board, has evidenced Treasury Board's responsibility by signing the statements of responsibility which are included with the financial statements. The

Comptroller General, likewise, by signing the financial statements, has evidenced the responsibility of that position. These signatures now clearly articulate the responsibility for the government's accounting policies and financial statements as assigned under FAA.

Comments on Specific Audit Findings

1994/95 Grants Paid in 1993/94

In March 1994, the Ministry of Forests and the Ministry of Small Business, Tourism and Culture obtained Treasury Board approval to prepay approximately $22 million in grants to various organizations. Since the government's accounting policies state that grants must be recorded as expenditures when disbursement of the funds has been authorized, these grants were recorded as 1993/94 fiscal year expenditures. Both ministries had sufficient available funds in their 1993/94 budgets to account for the above expenditures without exceeding annual appropriation limits.

The grants were used by the recipient organizations to meet regular operating expenditures and, as the funds related to 1994/95 fiscal year operating expenditures, the organizations did not record them as revenue in their 1993/94 financial statements.

Although all the required approvals were obtained and the expenditure recording met the government's stated accounting policy, we do not think that including these expenditures in the 1993/94 fiscal year is good accounting. As a result of this approach, the actual spending requirements of the two ministries for the 1993/94 fiscal year are not accurately disclosed in the Public Accounts, and 1994/95 fiscal year expenditures will be understated.

If the government had recorded government transfers in the manner recommended by the PSAAB, as we have called for later in this section, this accounting treatment would not have been permitted. The recommended standards require that transfers be accounted for in the same period in which the events giving rise to the transfers occurred.

Corporation Capital Tax: Audit and Accounting Procedures Need Improvement

On June 5, 1992, the *Corporation Capital Tax Act* (CCT) was passed effective April 1, 1992. This self–assessing tax on corporations is based on their capital as determined by the Act. The capital threshold was set at $1 million until 1993, when it was increased to $1.25 million. Each corporation whose annual tax liability exceeds $3,000 is required to make quarterly tax installments and file an annual return. The tax liability is based on the computation of the corporation's capital determined for the purpose of this tax.

At the time of our audit, the Ministry of Finance and Corporate Relations was still in the process of establishing an organization to audit these returns, and had insufficient resources to handle assessment volumes. Additional staff had been approved but were not yet in place. Approximately 21,800 returns filed (or 75% of the total) had not been assessed.

For the 25% of the returns which had been assessed, the tax calculation was based only on financial information provided by the corporations with their CCT returns. No return had undergone a field audit—a process we believe to be a most important control in administering a self–assessing tax.

We also noted that, although CCT administration was able to track individual CCT returns through its computer systems, it was not able to provide accounting information on accruals, aging, and other financial statistics necessary for financial statement preparation.

Given these circumstances, we devoted extra staff resources to working closely with the ministry so that we could arrive at a reasonably accurate estimate of the CCT revenue to be reported in the government financial statements for the year ended March 31, 1994.

The ministry has now assigned additional staff to the processing of the considerable backlog of returns and conducting field audits. We recommend that it continue to give priority to these tasks and that it also upgrade its records to enable it to provide information on accruals, refunds, and other details needed for financial statement preparation.

Liability for Post–retirement Benefits Needs to Be Estimated

Many retired members of the Public Service Superannuation Plan and other government–funded pension plans receive benefits that are paid for by the employers. These can include, for example, all or a portion of the pensioner's premiums for the Medical Services Plan and extended health care premiums.

In its financial statements, the provincial government accounts for post–retirement benefits only to the extent they are paid. However, because the benefit entitlements are earned throughout an employee's service life, we believe they should be recognized as a liability even though they may not be paid until retirement. At present, neither the liability for unpaid benefits earned by retired employees nor the amount required to fund benefits for current employees is recorded in the financial statements.

When the CICA's accounting standards for pensions were first introduced in 1986, the question of post–retirement benefits was also considered. It was felt, however, that more study was required. In the United States, the Financial Accounting Standards Board requires the cost of post–retirement benefits to be included in financial statements prepared in that country. Recently the CICA has suggested that Canadian companies prepare themselves for standards requiring inclusion in their financial statements of the costs and liabilities of post–retirement benefits. Some Canadian companies have already complied with this guidance.

We should point out that, for the first time, the government's financial statements do mention these liabilities in note 20, which details contingencies and commitments. Although we commend the government for this disclosure, we believe that it should go further by reporting in its financial statements all of its assets and liabilities, including post–retirement benefits earned by government employees. Only in this way can the financial position of the government and its future spending requirements be properly assessed.

We recommend that an actuarial valuation of post–retirement benefits be prepared. Once the valuation is complete, the government should record its liability for post–retirement benefits in its financial statements.

Accounting for Government Transfers

The CICA Public Sector Accounting Statement 7, titled "Accounting for Government Transfers" (issued November 1990), contains recommendations for the accounting treatment of monies transferred by the government to individuals, organizations, or other governments.

We reported on this issue in the Auditor General's report to the Legislative Assembly issued January 1993. We said that, although we noted progress during the 1991/92 fiscal year, no changes to accounting policies resulted. Discussions with government officials that continued during the 1992/93 and 1993/94 fiscal years produced no conclusions either. We believe Statement 7 provides important guidance to a more meaningful and consistent recognition of some $14 billion of government expenditure.

Again, we urge the government to adopt, as soon as possible, the recommendations of CICA Public Sector Accounting Statement 7 on accounting for government transfers.

Improved Accountability Through Better Information

Comments on the Completeness of the Province's Summary Financial Statements

The Public Accounts are the primary documents used by the government to demonstrate its financial accountability. Since 1981, the government of British Columbia has been including the Summary Financial Statements in its Public Accounts. These statements are designed to account for the full nature and extent of the financial affairs and resources for which the government is responsible.

Background

Our recent reports on the Public Accounts raised concerns about the adequacy of information contained in the Summary Financial Statements. Last year we discussed ways in which the government could improve its financial reporting. These included changing the accounting for loans recoverable only from future appropriations, changing the composition of the government reporting entity, and changing the accounting for government enterprises in the Summary Financial Statements.

In this report, we provide a summary of our last year's comments on these matters, together with additional information and analysis resulting from developments over the current year.

Last Year's Report

Amounts recoverable only through future appropriations

In our three previous reports on the Public Accounts, we discussed the valuation of the assets categorized in the financial statements of the government under "Fiscal Agency Loan Program." Through this program the government borrows funds to make loans to public sector organizations, including several of those included in the government reporting entity. We recommended that those loans which are recoverable only from future government appropriations be reduced in value, through the establishment of valuation allowances, to the amounts estimated to be realizable from sources outside the government financial reporting entity.

As an interim measure, the government agreed to report amounts recoverable substantially from future grant appropriations by way of a note in its financial statements for the years ended March 31, 1992 and 1993.

The composition of the government reporting entity

We also commented, in our three previous reports, on the composition of the government reporting entity. We noted that the government has adopted the criteria recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants for determining which organizations should be included in the government's financial reporting entity. These criteria, set out in note 1(a) of the Summary Financial Statements, call for the inclusion in the government's financial statements of those organizations that are accountable for the administration of their financial affairs and resources either to a government minister or directly to the legislature, and that are owned or controlled by the government.

These inclusion criteria are further clarified by the Public Sector Accounting Statement 4 issued by PSAAB. It states that "regardless of the form of an organization or the nature of its activities, if the government owns or controls an organization, the government is accountable for that organization's financial affairs and the use of its resources."

For these reasons, we recommended that the following advanced education institutions be included in the financial reporting entity:

- provincial public universities,
- colleges and provincial institutes, and
- the Open Learning Agency.

We also suggested that the government analyze further the question of accountability, control, and, in particular, ownership of the province's public hospitals before deciding whether or not they should also be included in the government reporting entity.

Accounting for government enterprises

According to existing government accounting policies, entities making up the summary reporting entity are grouped into two categories: government enterprises and government organizations. Both of these two groups are defined in note 1 of the Summary Financial Statements.

The 23 government enterprises, which include British Columbia Hydro and Power Authority, British Columbia Ferry Corporation, and Insurance Corporation of British Columbia, are recorded in the Summary Financial Statements on the "modified equity" basis. This means that only the cost of the government's investment in the government enterprises, adjusted for any increase or decrease in their net assets, is included in these financial statements.

In our report on the Public Accounts last year, we noted that the accounting policy for consolidating government enterprises on a modified equity basis seems to be inconsistent with the gross basis of accounting which is fundamental to the Summary Financial Statement presentation. The modified equity basis requires the net assets of the commercial entity—rather than the economic substance of its underlying components—to be aggregated with other economic activities of the government. The existing accounting treatment for these enterprises, we emphasized, results in a significant amount of revenues, expenditures, assets, and liabilities of government enterprises not being disclosed in the Summary Financial Statements. To demonstrate the significance of the information currently missing from government financial statements, we provided in our last report a pro forma set of summary financial statements prepared on the basis that government enterprises were consolidated line–by–line.

Government Actions on Our Previous Comments

We stated, in our previous report on the Public Accounts, that the over–valuation of loans made under the Fiscal Agency Loan Program has resulted in a material misstatement of the financial position of the government. However, in recognition of the government's commitment and determination to resolve this and two other important accounting issues (the recording of physical assets and the composition of the summary reporting entity), the Auditor General decided to postpone including a reservation in his reports on both the Summary Financial Statements and the Consolidated Revenue Fund Financial Statements.

We received the following commitment from the Deputy Minister, Ministry of Finance and Corporate Relations, on addressing this issue:

> *We have been concerned about the limited basis of government accountability that uses the 'net debt concept' as the sole focus of the balance sheet. We believe that this is an important measure, although one that needs refinement, but it is not the only measure.*
>
> *Serious consideration is being given to the recording and depreciation of the government's physical assets. This consideration includes a review of the best way in which to report our Fiscal Agency Loans and Capital Grants which are made for the purpose of obtaining physical assets for organizations not currently part of our consolidated entity. This, naturally, also leads to review of the entity.*
>
> *We anticipate that a recommendation on these matters will be made to Treasury Board before the middle of the next fiscal year.*

Developments Since Our Last Report

A number of developments since our report on the 1992/93 Public Accounts indicate that both the government and PSAAB are addressing the issues we have raised about the completeness of the government financial statements.

First, in the 1993/94 Public Accounts, the government made a significant change in disclosing loans that are recoverable only through future government appropriation, by correctly excluding them from financial assets. As a result of this change, the province's net liabilities—the difference between liabilities and financial assets—were, for the first time, disclosed in the government's financial statements. We have further discussed this change in the section of this report titled, "Amounts Recoverable Only Through Future Government Funding," page 22.

Second, the Comptroller General informed the Auditor General that the government is currently looking at issues which, in the Comptroller General's view, would satisfactorily address the matter of completeness of the Summary Financial Statements. The letter stated that:

> *We have received approval from Treasury Board and Cabinet to proceed with an orderly process to institute capitalization and depreciation of physical property in the Province's financial statements. This process allows time for discussion and consultation before proceeding to record any assets that do not presently appear on our statements.*
>
> *As you so correctly observed, the issue of Fiscal Agency Loans is tied directly to the question of the entity. We shall be reviewing our entity over the next few months in order to make recommendations to Treasury Board.*

As well, PSAAB has made progress on these matters. In a recent communication with its associates, it disclosed that it is re–examining the criteria for setting the composition of the government reporting entity. It has identified "accountability" as a main criterion and it is also re–examining its definition of "control." This re–examination of standards undertaken by PSAAB is a good indication of the difficulties governments and legislative auditors face in addressing government accountability and defining "government."

Our Office has a keen interest in assisting PSAAB and the government in better defining the structure of the government's summary reporting entity. We believe this work is essential to helping ensure that the Summary Financial Statements account for all activities of the government. Among the questions still be to asked is whether such organizations as school districts should be included in the government financial statements.

Conclusion

The Auditor General is pleased that loans recoverable only from future government appropriations are no longer included in the government statements of financial position as financial assets. The government's financial statements now, for the first time, show clearly the difference between the government financial assets and its liabilities—a key performance indicator. Still to be resolved, however, is whether these loans should be recognized as assets of any kind. We expect this issue to be resolved at the conclusion of the government and PSAAB reviews.

We also believe that, once these issues are resolved, a better framework for financial reporting will be established, one in which the government can re–examine its accounting for government enterprises. We believe that, because government enterprises are established mainly to provide government programs, their activities should be consolidated in the same way as are those of government organizations.

We encourage the government's efforts in examining these issues which are so essential to improved financial accountability, and we will continue to offer our assistance in reviewing and assessing accounting policies being developed by it for this purpose. At the same time, we will continue to assist PSAAB in developing accounting and reporting standards for the public sector.

Implicit Expenditures Should Be Disclosed

What Are Implicit Expenditures?

Governments, in delivering programs, do not only spend and receive moneys directly, they also achieve program goals by providing tax relief or discounts on charges for goods and services they provide. Since these concessions are designed to achieve government objectives, it is generally accepted that they should be recognized in the same way as the cost of government programs. In this manner they are sometimes referred to as tax expenditures or, more accurately, "implicit expenditures."

The Estimates of Revenue and Expenditure, and the Public Accounts, are perhaps the most important links in the chain of accountability of the government. The Estimates set out the spending plan of the government and the plan's financing, and the Public Accounts report on the results of operations and financial position of the government. To make effective decisions about resource allocations and costs of government services, and to measure the economic impact of those operations, users of these documents need complete information.

However, as forgone revenue is equivalent to an expenditure, implicit expenditures should be evaluated as to their effectiveness in achieving objectives, their efficiency in balancing costs and benefits, and their equity in achieving social welfare goals. For such evaluation to take place, information about these expenditures should be included in the governments' accountability documents.

The Need for Information on Implicit Expenditures

In 1986, the Auditor General of Canada surveyed Members of Parliament about their need for information on tax expenditures. Their response was that it is generally impossible for them to evaluate the thrust of the government's social and economic policies unless they have such information. Similarly, a discussion in the British Columbia legislature on July 13, 1993, on the implicit tax preferences of the members recognized that "in fact we implicitly make those choices, and it is more desirable to have more information like that in the budget."

In 1981, the B.C. Ministry of Finance published a report listing

Implicit expenditures can be in the form of:

- ***Tax expenditures*** – These are financial benefits provided by the provincial government through the tax system, and include revenues postponed or forgone through such measures as exemptions, deductions, credits, preferential tax rates, deferrals, and omissions.

  Under the terms and conditions of the federal–provincial tax agreement, the federal government collects provincial personal and corporate taxes on behalf of British Columbia. The province assesses its income tax on a base determined by federal legislation. As a result, most tax expenditures introduced in federal income tax legislation will result in similar, but smaller, tax expenditures and forgone provincial revenue. For other taxes, the provincial legislation determines the base.
- ***Incentives designed to attract and retain private sector investment*** – These include reduced utility, water, and infrastructure charges to targeted businesses, as well as the lease, sale, or rental of Crown land or other natural resources at below–market rates.
- ***Source withholdings*** – These are commissions and administrative charges allowed by the government to be withheld by the collecting agents to reimburse them for their costs. These charges are deducted from the revenue recorded by the government for taxes, licences, and other fees.

tax expenditures and quantifying their effect on the province's revenue. The report called for a complete statement of government's activities to include information on forgone revenue due to tax expenditures. However, 1981 was the only year this information was publicly provided.

Reporting Practices in Other Jurisdictions

Other jurisdictions in Canada (as early as 1979) and abroad have attempted to address the issue of disclosing in their public documents useful information on implicit expenditures. Extent of disclosure varies greatly from jurisdiction to jurisdiction.

In its annual Budget Address, the Province of Saskatchewan reports on social programs delivered through the tax system. The address itemizes tax expenditure estimates, calculated using tax collection and Statistics Canada data. The information disclosed includes the value of tax expenditures for:

- sales tax exemptions by type of goods or source;
- individual income tax, including deductions from income, personal tax credits, and other tax credits;
- corporate income tax, including expenditures due to the reduced small business rate;
- corporation capital tax exemptions; and
- fuel tax exemptions.

The Government of Canada publishes an annual report of personal and corporate tax expenditures. The report provides estimates of the cost of tax expenditures that take the form of preferential income exclusions, deductions, deferrals, or credits. The purpose of the report is “to serve as a source of information for parliamentarians, government officials and others who wish to analyze Canada’s federal income tax system. It is also an important input into the process of evaluating the tax system’s operation.” Although there is no attempt made in the document to gauge the performance of each of the legislated provisions, the figures can be used to measure the amount of implicit expenditure granted a given program, as provided for by forgone taxation revenue.

The United States Treasury Department has been publishing tax expenditure budgets since 1968. In 1974, this information was incorporated into the *Congressional Budget Act*. Accordingly, all budgets after 1975 have contained a special analysis which provides a detailed tabulation of tax expenditures. The Act also created a committee whose job it is to request and evaluate continuing studies of tax expenditures, and to devise methods of coordinating tax expenditure policies and programs with direct budget outlays. Some states, including California, provide tax expenditure information as well.

Since 1981, France’s *Finance Act* has required that the government set out the initial estimates of tax expenditures, as well as the results (classified in detail by nature of the taxes) by objectives and by categories of beneficiaries.

Current Reporting Practice in British Columbia

Only limited information on implicit expenditures is available in the province’s Estimates of Revenue and Expenditure and in the Public Accounts.

A note in the Estimates provides information on agents’ commissions and collection fees ($22,500,000 for 1994/95), that are netted against taxation revenue collected. As well, the note includes an estimate of the amounts of the homeowner grants ($400,000,000 for 1994/95), netted against residential property tax.

The 1992/93 Public Accounts contain a footnote saying the personal and corporate income tax revenues are recorded after adjustment for foreign tax, logging tax, venture capital tax, and political contribution credits, as well as for low income rent reductions, low income tax rebates, and royalty tax rebates. The note also says that the personal income tax was reduced by $35,139,646 and the corporate income tax increased by $15,702,512 as a result of these adjustments. In another footnote, $399 million of homeowner grants are also netted against residential property tax.

Neither the Estimates nor the Public Accounts include information on the value of many implicit expenditures, such as those incurred through income taxes or non–tax incentives—reduced utility rates, preferential royalties, or stumpage rates, for example.

Overall, then, the government accounting policies provide no financial reporting standards for revenue concessions (except for interest income earned from concessionary loans), and the level of information disclosure in the province's Estimates and the Public Accounts is minimal.

What Is the Dollar Value of Implicit Expenditures of the Province?

We obtained our information from a variety of sources, many of which have not been audited. Where information was not available, we have made assumptions; where two or more estimates for a particular expenditure existed, we have selected the most conservative value. We believe this degree of accuracy is adequate at this time to demonstrate the relative size and significance of these hidden program costs.

Estimates of tax expenditures for programs administered solely by the provincial government are based on information gathered through discussions with various ministry officials. Estimates of implicit expenditures relating to programs jointly administered by the federal and British Columbia governments are based on data published in the Government of Canada December 1993 report titled "Personal and Corporate Income Tax Expenditure." In that report, corporate tax information pertains to 1990 and the personal income tax information to 1991.

Much more study is required for the following tax expenditures, and for all other implicit expenditures of the revenue concessions type (such as forgone revenue resulting from concessionary rates charged for seniors' transportation, or from electric power generated and used by certain corporations):

- exclusions of products or services from social services tax;
- preferential treatment of certain industry sectors for fuel tax;
- exemptions from, and deductions allowed for, resource taxes, such as accelerated depreciation, research and development, and capital improvements on Crown land; and
- exemptions from, and reduced tax rates allowed for, corporation capital tax.

A breakdown of the amount of estimated tax expenditures and source withholdings are shown in Exhibit 3.1. A summary of these expenditures is outlined below:

	$ Million
Provincial programs	
Source withholdings	21
Tax expenditures	429
Personal and corporate classification	32
Combined federal–provincial programs	
Corporate classification	172
Personal classification	2,636
Total	3,290

We did not attempt to determine the amount of these implicit expenditures.

Conclusion and Recommendation

Despite the significance of implicit expenditures, only very limited information is publicly available about them and, as they are not included in the Estimates appropriations, they are not subject to the same legislative control as are regular expenditures. Because they are a major component of the cost of delivering government programs, we believe that more information about them should be available to the legislature to enable members and the public to evaluate whether implicit expenditures are achieving their objectives. This information should be included in the governments' accountability documents.

We recommend that information about implicit expenditures be disclosed in the province's Estimates and the Public Accounts.

Programs administered jointly by the federal and provincial governments: provincial portion ***(continued)***

$500,000 lifetime capital gains exemption for farm property	15
$100,000 lifetime capital gains exemption	42
Partial inclusion of capital gains	42
Deduction of limited partnership loss	15
Non–taxation of employer–paid insurance premiums for group private health and welfare plans	52
Disability credit	16
Medical expenses credit	13
Non–taxation of guaranteed income supplement and spouse’s allowance payments	15
Non–taxation of social assistance payments	18
Non–taxation of workers’ compensation payments	44
Non–taxation of employer–paid premiums for group term life insurance of up to $25,000	10
Non–taxation of veteran's disability pension and support for dependents	9
Treatment of alimony and maintenance payments	13
Age credit	83
Pension income credit	18
Registered Retirement Savings Plans:	
– deduction for contributions	209
– non–taxation of investment income	187
– taxation of withdrawals	(46)
Registered Pension Plans	
– deductions for contributions	282
– non–taxation of investment income	566
– taxation of withdrawals	(255)
$500,000 lifetime capital gains exemptions for small business shares	37
Deduction of allowable business investment losses	8
Non–taxation of capital gains on principal residences:	
– partial inclusion rate	202
– full inclusion rate	280
Charitable donations credit	53
Child care expense deduction	21
Deduction of carrying charges incurred to earn income	41
Meals and entertainment expenses	6
Deduction of other employment expenses	31
Deduction of union and professional dues	26
Unemployment Insurance:	
– unemployment insurance	63
– non–taxation of employer–paid premiums contribution credit	127
Canada and Quebec pension plan credit	55
Non–taxation of employer–paid premiums	71
Foreign tax credit	4 **
Dividend gross–up and credit	44
	2,808
Total	3,290

Sources: Provincial taxation estimates, Government of Canada report titled “Personal and Corporate Income Tax Expenditure,” Statistics Canada and:

* obtained from the “First Estimate of Payments Under the Tax Collection Agreements for the 1994 Taxation Year,” prepared by the Federal Government of Canada, February 11, 1994.

** obtained from the “Final Determination of Payments Under the Tax Collection Agreements for the 1993 Taxation Year,” prepared by the Federal Government of Canada, February 9, 1994.

*** obtained from the audited financial statements of the Province of British Columbia, as at March 31, 1994.

Exhibit 3.1

The Province of British Columbia's Tax Expenditures and Source Withholdings

Details of the amounts of estimated tax expenditures and source withholdings for programs administered solely by the province or jointly with the federal government ($ Millions)

Programs administered solely by the provincial government

Source Withholdings		
Commissions withheld by the remitter once the tax collected has been remitted to the province:		
Social Services Tax	19	
Hotel Room, Fuel, Tobacco, Horse and Auto Racing	2	
Tax Expenditures		
Deductions from the property taxes otherwise collectable by the province:		
Home Owner Grants	400	
Industrial Improvements Abatement	14	
Farm Status Abatement	11	
Tourist Accommodation Abatement	4	
Personal and Corporate Classification		
Political Contribution Tax Credit	1	
Venture Capital Tax Credit	7	**
Renter's Tax Reduction	17	**
Employee Venture Capital Tax Credit	3	**
Logging Tax Credit	3	**
International Financial Business Tax Refund	1	***
	482	

Programs administered jointly by the federal and provincial governments: provincial portion

Corporate Classification		
Low tax rate for small businesses	123	*
Low tax rate for manufacturing and processing	2	
Scientific Research & Experimental Development Tax Credit	4	
Investment Tax Credits	1	
Partial inclusion of capital gains	3	
Fast write–off for Canadian development expenses	1	
Fast write–off of Canadian exploration expenses	3	
Interest on foreign currency deposits	4	
Excess of tax depreciation over book depreciation	6	
Refundable Part I tax on investment income of private corporations	7	
Loss carry–overs – Non–capital losses	11	
Meals and entertainment expenses	3	
Large corporations tax threshold	3	
Patronage dividend deduction by credit unions and cooperatives	1	
Personal Classification		
Lottery and gambling winnings	54	
Tuition fee credit	9	
Education credit	2	
Education and tuition fee credits transferred	8	
Northern benefits deductions	15	
Married credit	70	
Equivalent–to–married credit	36	
Dependent credit	25	

Provincial Debt: Comments on Its Reporting

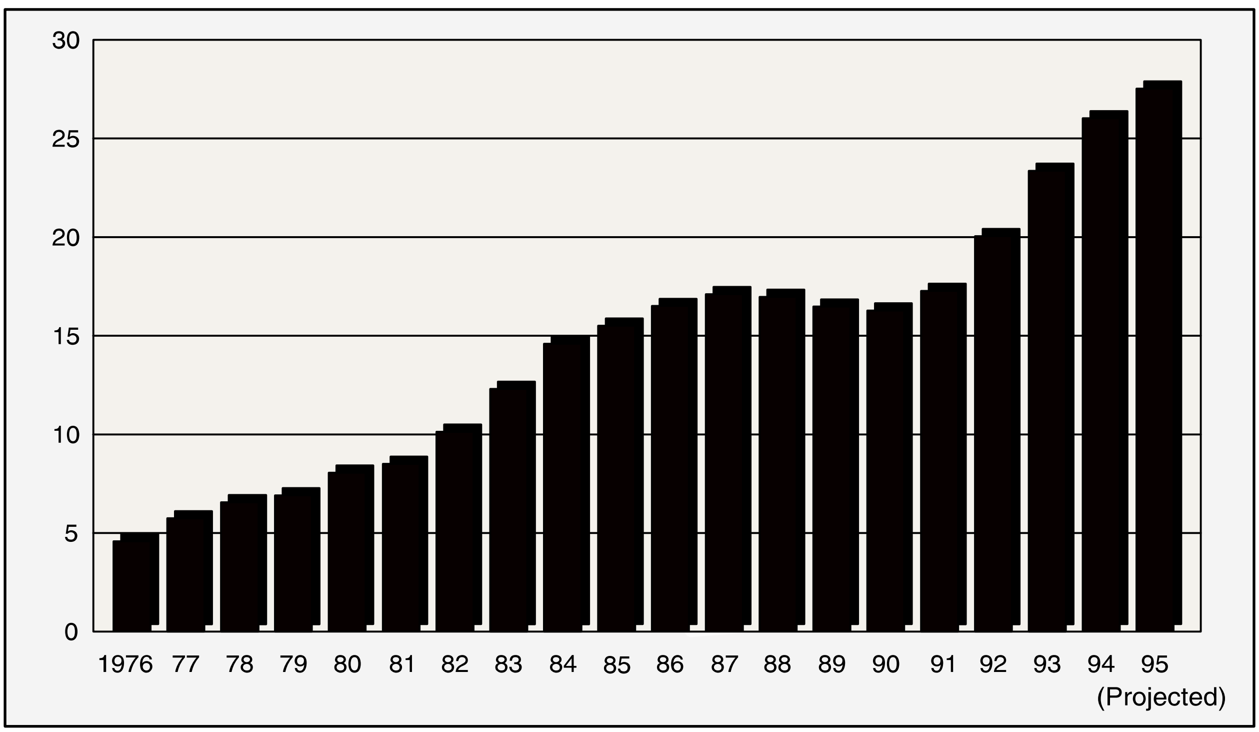
The debt of the Province of British Columbia has increased from $16.3 billion in 1990 to $26.0 billion in 1994, an increase of 60% over four years. Its increase during the 1993/94 fiscal year has been 11%, from $23.4 billion to $26.0 billion. Each British Columbian's share of the provincial debt has increased from $4,965 to $7,189 between 1990 and 1994. Exhibit 4.1 shows the total provincial debt for each of the 20 fiscal years 1975/76 to 1994/95.

The public is concerned about the extent of provincial debt. We believe that better information about debt would allow people to

Exhibit 4.1

Total Provincial Debt

Total debt for each of the 20 fiscal years ending 1994/95 ($ Billions)



Source: The Public Accounts, Budget '94, Economic and Statistical Review reports better understand provincial borrowing and how it affects them.

The Auditor General's Report on the 1992/93 Public Accounts included various recommendations on how the reporting of debt could be improved. We suggested that the government consider reporting in the Public Accounts information about the total provincial debt, changes in debt, the financial well–being of the province, and the cost of debt servicing. We also suggested that key performance indicators be included to show trends in provincial debt.

During the 1993/94 fiscal year, the government has made few changes to what it reports about provincial debt. Some additional information has been provided in both the Budget and the Economic and Statistical Review, but it continues to be incomplete and widely scattered throughout various government publications.

In Exhibit 4.2, we summarize the items we recommended for disclosure and indicate the extent to which government publications now include information about them.

The information needed to calculate a few of the measures and indicators we recommended in Exhibit 4.2 is not currently being disclosed by the government. Thus, in our comments here we have not addressed the effects of operating deficit on provincial debt.

Exhibit 4.2

Measures and Indicators Recommended for Disclosure in the Public Accounts

Are they disclosed in government publications?

Recommended Measures and Indicators	Public Accounts	Public Accounts Digest	Economic and Statistical Review	1994/95 Budget
1. Debt to revenue	No	No	No	No
2. Total provincial debt	No	No	Yes	Yes
3. Debt per capita	No	No	Yes	No
4. How debt changed	Partially	No	Partially	Partially
5. Why debt changed, including the operating deficit	No	No	No	No
6. Sources of borrowing	No	No	Yes	Yes
7. Interest bite	No	Partially	No	No
8. Debt to GDP	No	Yes	Yes	Yes
9. Total cost of debt servicing	No	No	No	No
10. Rate of interest	Partially	No	No	No

Source: The Public Accounts, 1992/93 Public Accounts Digest, Budget '94, 1993 BC Economic and Statistical Review

Total Provincial Debt

The total debt of the province is composed of amounts borrowed by the province for the operation of the central government (direct), for government agencies (other), and the third–party guaranteed debt. Exhibit 4.3 shows a breakdown of direct, other, and third–party guaranteed debt as at March 31, 1994. Total provincial debt at March 31, 1994, was $26.0 billion. This consisted of the $22.7 billion in debt reported in the Summary Financial Statements, together with $2.9 billion in additional debt of “government enterprises” and $0.4 billion in third–party guaranteed debt.

Two important indicators of trends in provincial debt are “debt per capita” and “debt to revenue.”

Exhibit 4.3

Total Debt

Details of total provincial debt as at March 31, 1994 ($ Millions)

Direct debt		**10,257**
Debt of Crown corporations and agencies		**15,335**
BC Buildings Corporation	612	
BC Ferry Corporation	415	
BC Hydro and Power Authority	7,680	
BC Lottery Corporation	5	
BC Railway Company	316	
BC Systems Corporation	26	
BC Transit	1,348	
BC Transportation Financing Authority	73	
Capital Project Certificate of Approval Program	408	
Duke Point Development Limited	3	
Educational Institutions	1,116	
Greater Vancouver Sewerage and Drainage District	197	
Greater Vancouver Water District	130	
Improvement Districts	3	
Pacific National Exhibition	7	
Pacific Racing Association	5	
Provincial Rental Housing Corporation	99	
Regional Hospital Districts	1,087	
School Districts	1,804	
W.L.C. Developments Ltd.	1	
Third–party guaranteed debt		**426**
Total provincial debt		**26,018**

Note: Debt includes regular borrowings, capital leases, notes payable, and minority interests.

Source: The Public Accounts

Debt Per Capita

As a performance indicator, the debt per capita shows the average amount of provincial debt owing by each British Columbian. It is calculated by dividing the total debt of the government by the population of the province.

Exhibit 4.4 shows the debt per capita for the last five years. Debt per capita has increased every year since 1990. It stood at $7,189 at March 31, 1994, an increase of $548 in one year.

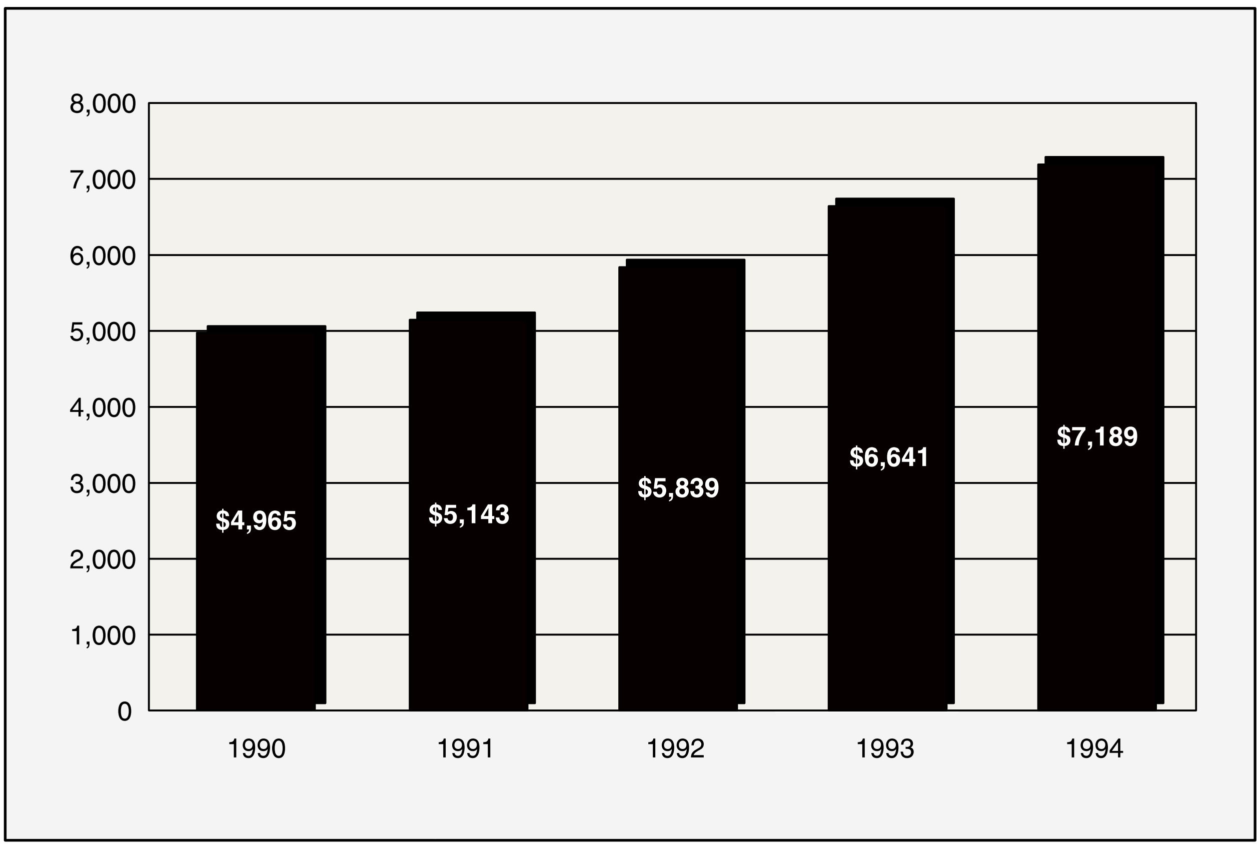
Debt to Revenue

Another frequently used indicator is debt to revenue. Calculated as the ratio of debt outstanding at yearend compared to revenue from all sources for that year, it indicates how many years of revenue it would take to repay the provincial debt. Comparing this ratio for the 1992/93 fiscal year (96%) to that of the 1993/94 fiscal year (98%) shows that in the latter year the rate of increase in debt has been higher than the rate of increase in revenue.

Exhibit 4.4

Debt Per Capita

Average share of provincial debt of a person living in British Columbia, 1990 to 1994



Source: The Public Accounts for debt, Statistics Canada for population as at March 31

This section is continued in Section 7a (Provincial Debt: Comments on Its Reporting).

Click here to proceed to Section 7a.

Financial Highlights

The financial information highlighted in this section is intended to provide background to, and serve as a point of reference for, our comments on the state of the province's debt and deficit. The comments are made, in keeping with the direction provided by Section 8(1) of the *Auditor General Act*, to highlight certain important financial information contained in those statements. Financial data are taken from the summary level financial statements included in the Public Accounts of the relevant years. Amounts are restated to take into account the effects of any prior period adjustments. The restated 1993 amounts have been audited, whereas the restated prior years' amounts are from unaudited schedules in the Public Accounts. Financial data are not adjusted for changes in the Consumer Price Index (CPI). Population figures are from statistics as at March 31 of each year.

In its 1994 Budget, the government reported an overall economic growth in 1993 of 3.2%—a level that it had anticipated in its previous year's Budget. According to the government, the outlook for 1994/95 is expected to be an overall economic growth of 3.4%, resulting in some 47,000 new jobs in British Columbia.

On the basis of its fiscal plan, the government continues to aim for a substantial reduction in annual deficits, stating that the deficit will be eliminated in 1996/97.

Revenue

Taxes are the most significant source of revenue for the government of British Columbia. In recent years, personal taxes have accounted for between 40 and 45 cents of every dollar of the province's taxation revenue. Compared with all other major sources of revenue, personal taxes have had the highest dollar increase over the past five years, increasing by $900 million.

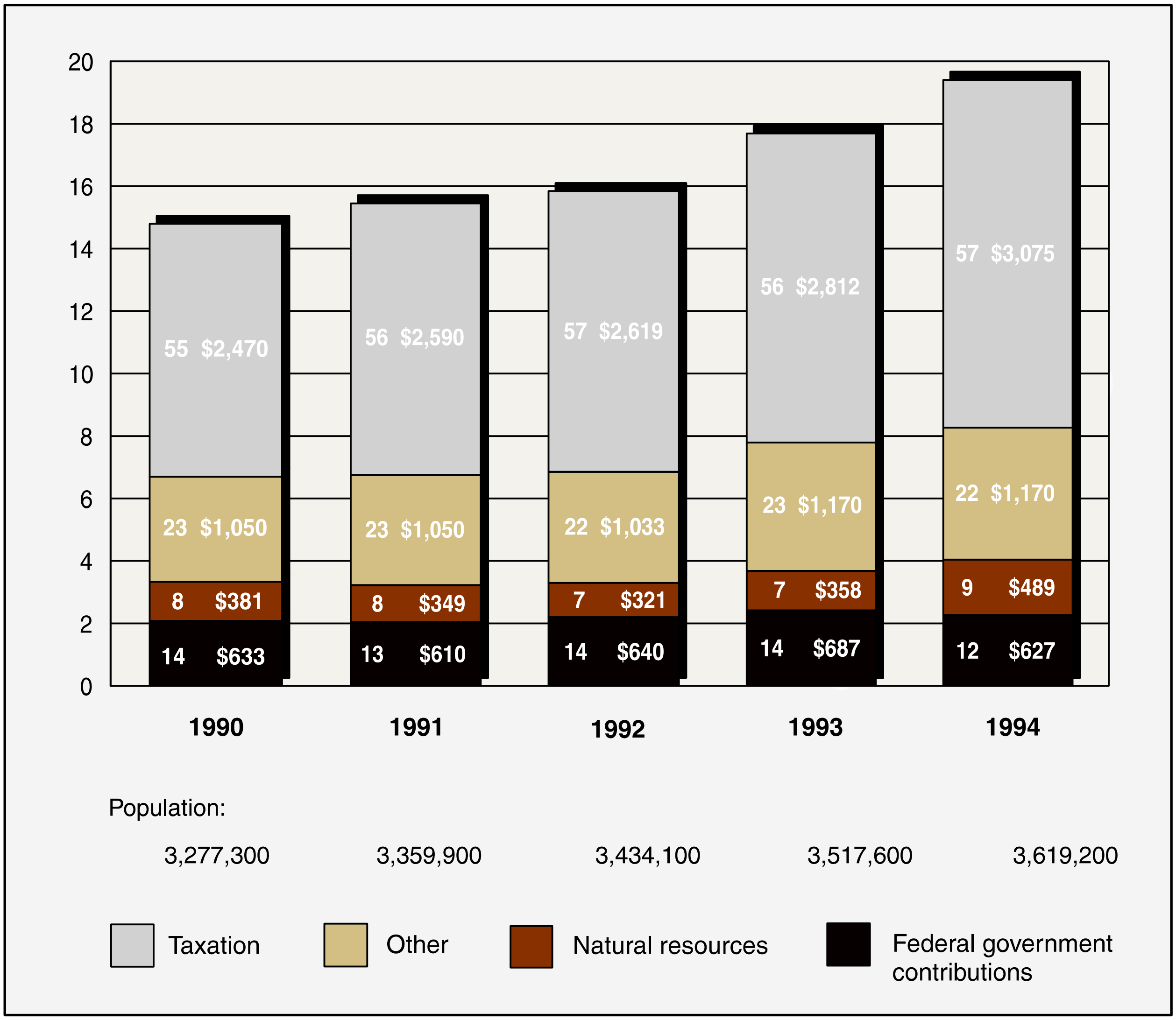
For the 1993/94 fiscal year the largest percentage increase in revenue by main source was "natural resources revenues." These increased 41% from $1.3 billion to $1.8 billion.

Exhibit 5.1 shows total revenue of the province in each of the years 1990–1994. Taxation revenue has increased significantly from $8.1 billion in 1990 to $11.1 billion in 1994. Expressed in other terms, this means that the average taxation revenue generated by each resident of British Columbia (per capita taxation revenue) has increased from $2,470 in 1990 to $3,075 in 1994.

Exhibit 5.1

Revenues, 1990 to 1994

Total, percentage of total, and per capita revenue, by main sources over the past five years ($ Billions)



Source: The Public Accounts for financial figures, Statistics Canada for population statistics as at March 31

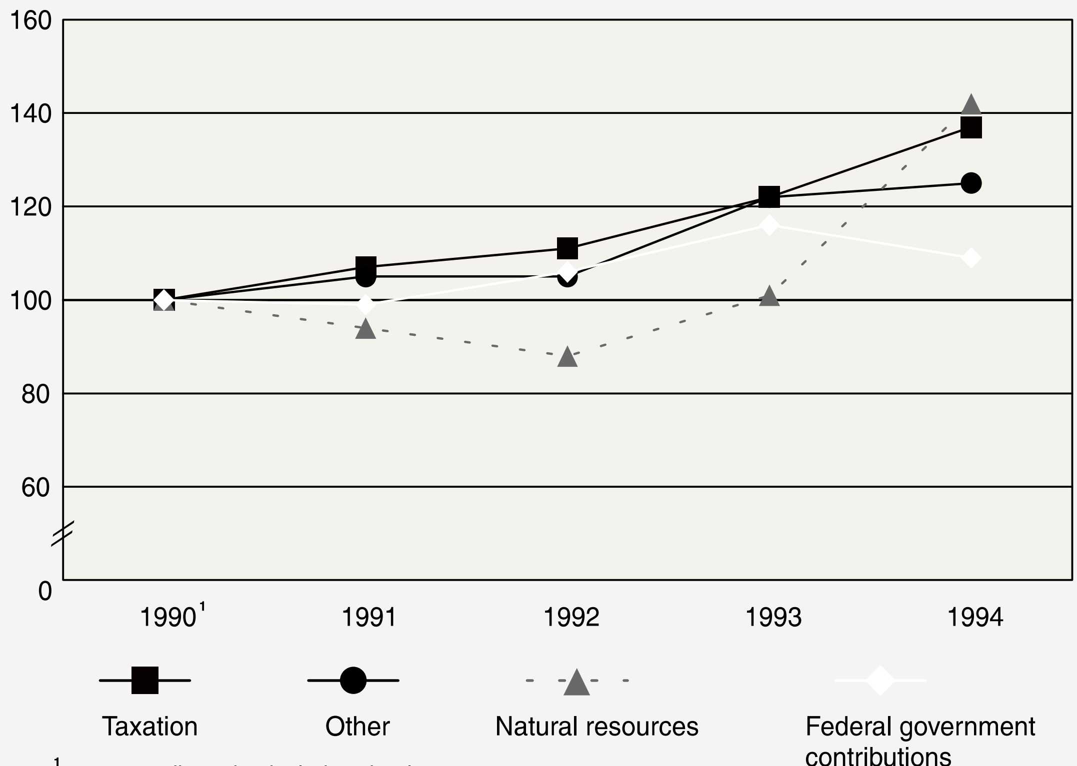
The revenue category referred to as "other" includes all fee and license collections, earnings from investments, contributions from government enterprises, recovery of moneys from sources outside government, and some miscellaneous revenue.

Exhibit 5.2 shows the rate of change in revenue over the last five years by main sources. The base year in this exhibit is 1990. Revenue for each main source in the four years that follow 1990 has been shown as a percentage of the base year. Note that in 1990 the school tax component of

Exhibit 5.2

Change in Revenues, 1990 to 1994

Rate of change in revenue by main sources, over the past five years, (1990 = 100)



[1] 1990 not adjusted to include school property taxes.

Source: The Public Accounts

property taxes became the direct revenue of the province rather than of the various municipalities. The large percentage increase from 1990 to 1991 in taxation revenues (7.5%) can be partially (3.8%) attributed to this administrative change in collecting school tax. The province's education expenditure also increased correspondingly in 1991. Because school tax and the corresponding education expenditure were not revenue and expenditure of the province in the 1989/90 fiscal year, we have not adjusted the 1990 figures.

Exhibit 5.3 shows the taxation revenue by source over the five–year period from 1990 to 1994, and the ratio of revenue from each of the main taxation sources to the total taxation revenue of the province.

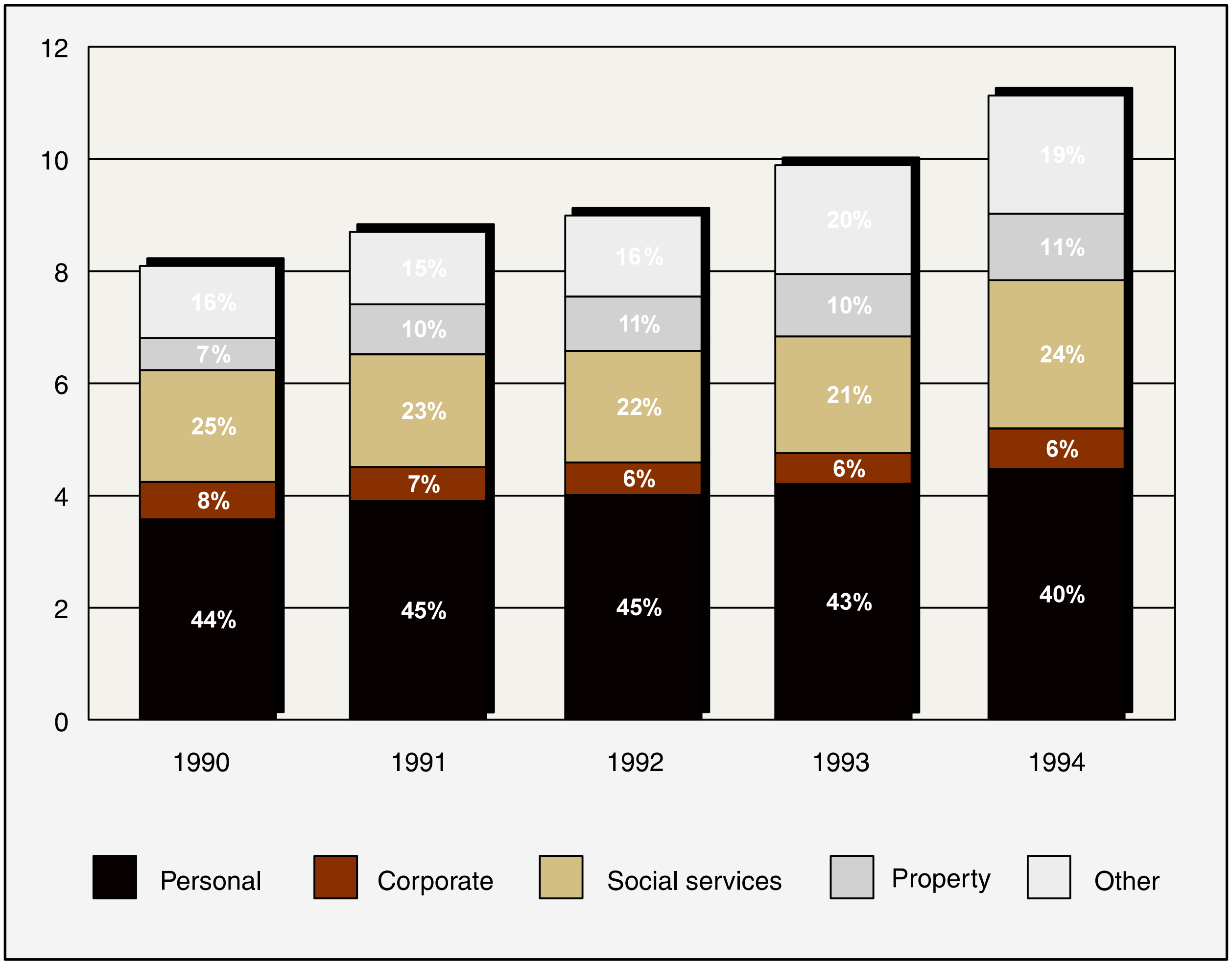
The government collects taxes from many sources. The most important of these taxes include those relating to personal and corporate income, property, and sales. In the figures presented in Exhibit 5.3, the taxes denoted as coming from property include residential, business, and rural property taxes. The Social Services Tax is more commonly known as the provincial sales tax. The "other" source includes property transfer, fuel, tobacco, and insurance premium taxes, in addition to hotel room, corporation capital, and horse racing taxes.

Exhibit 5.4 shows the rate of growth in major categories of taxation revenue compared with the rate of growth in the province's Gross Domestic Product (GDP) over the years 1990 to 1994. The GDP is used in this figure as an indicator of the province's economy. As in Exhibit 5.2, 1990 is taken as the base year for the comparison. The GDP data are for each calendar year ended in the respective government fiscal year.

Exhibit 5.3

Taxation Revenue, 1990 to 1994

Total, and percentage of total, taxation revenues by source over the past five years ($ Billions)



Source: The Public Accounts

This section is continued in Section 8a (Financial Highlights).

Click here to proceed to Section 8a.

This section is continued from Section 8.
(Financial Highlights)

Expenditure

In the last five years, health, education, and social services combined have accounted for an average of 67% of the total expenditure of the province:

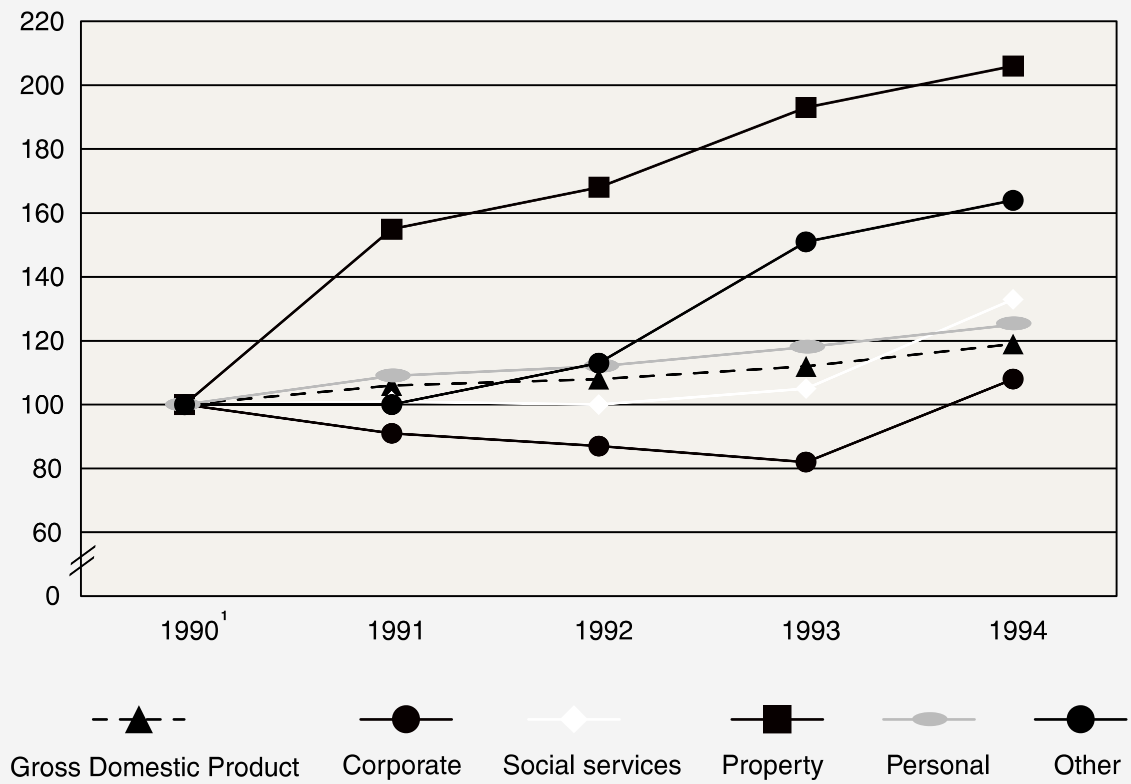
- Health costs have increased from $4.5 billion in 1990 to $6.3 billion in 1994, an increase of 40% over the past five years. In the 1993/94 fiscal year, the increase was 4% over the previous year.

- The cost to the province of educating our students has increased from $3.2 billion in 1990 to $5.0 billion in 1994, an increase of 54% over the past five years. In the 1993/94 fiscal year, the increase was 4% over the previous year.

Exhibit 5.4

Change in Taxation Revenue, 1990 to 1994

Rate of change in taxation revenue by major categories compared to Gross Domestic Product, (1990 = 100)



[1] 1990 not adjusted to include school property taxes.

Sources: The Public Accounts for financial figures, Statistics Canada for the province's Gross Domestic Product figures

- The cost of social services has increased from $1.5 billion in 1990 to $2.6 billion in 1994, an increase of 80% over the past five years. In the 1993/94 fiscal year, the increase was 14% over the previous year.

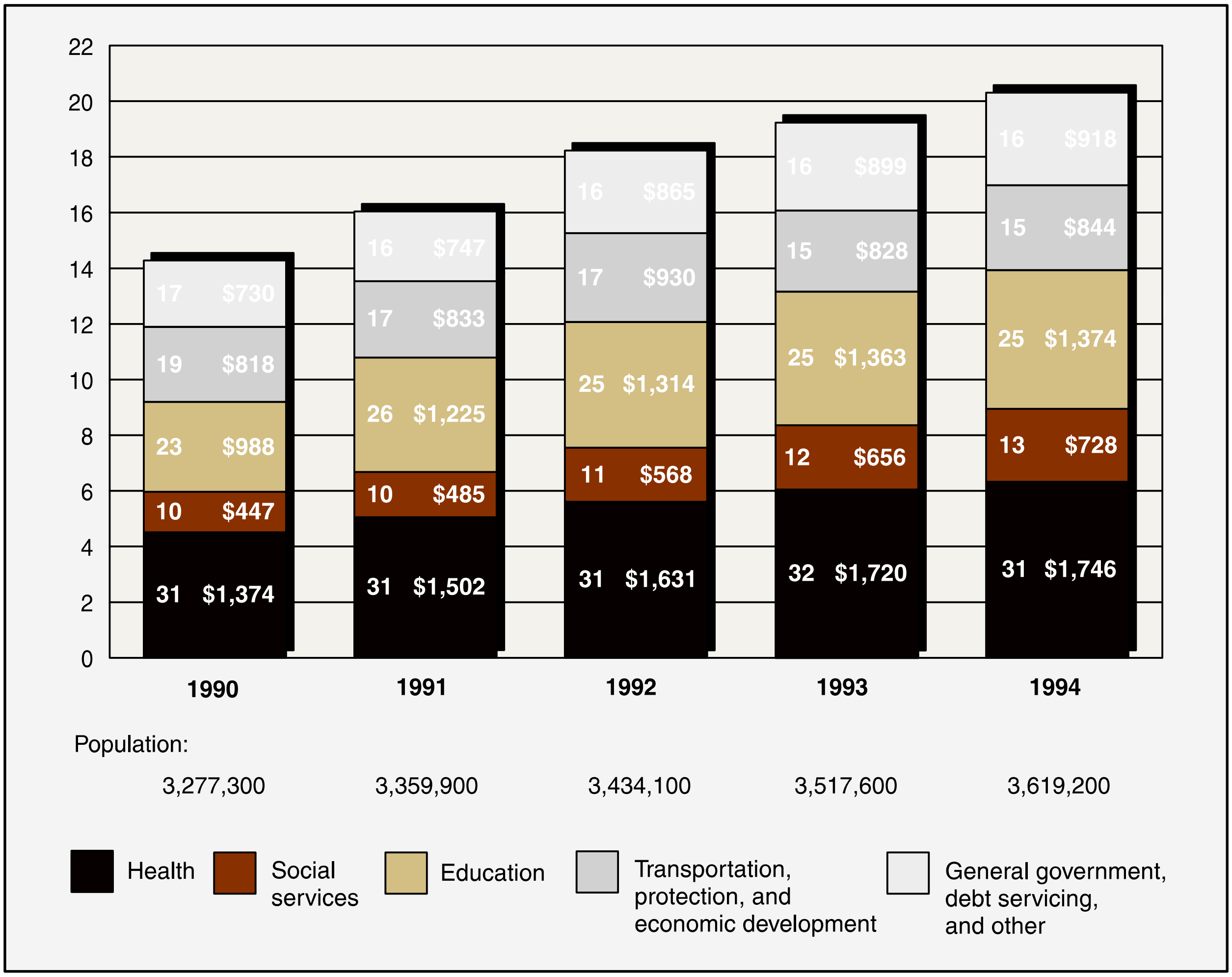
In the same five–year period, the province's population increased by 9% from 3.3 million to 3.6 million, and its GDP grew by 19% from $77 billion to $92 billion.

Exhibit 5.5 shows the province's total expenditure for each of the last five years. Expenditure is divided into five groups based on "functions." The three major functions—health, social services, and education—are shown separately. Transportation, protection, and economic development functions are

Exhibit 5.5

Expenditures, 1990 to 1994

Total, percentage of total, and per capita, expenditures by function group ($ Billions)



Source: The Public Accounts for financial figures, Statistics Canada for population statistics as at March 31 grouped, as are the general government, debt servicing, and all other functions. Exhibit 5.5 also provides information on average expenditure per resident of British Columbia (per capita expenditure) in each function group. For each function group, the percentage of expenditure in that group to the total government expenditure is shown.

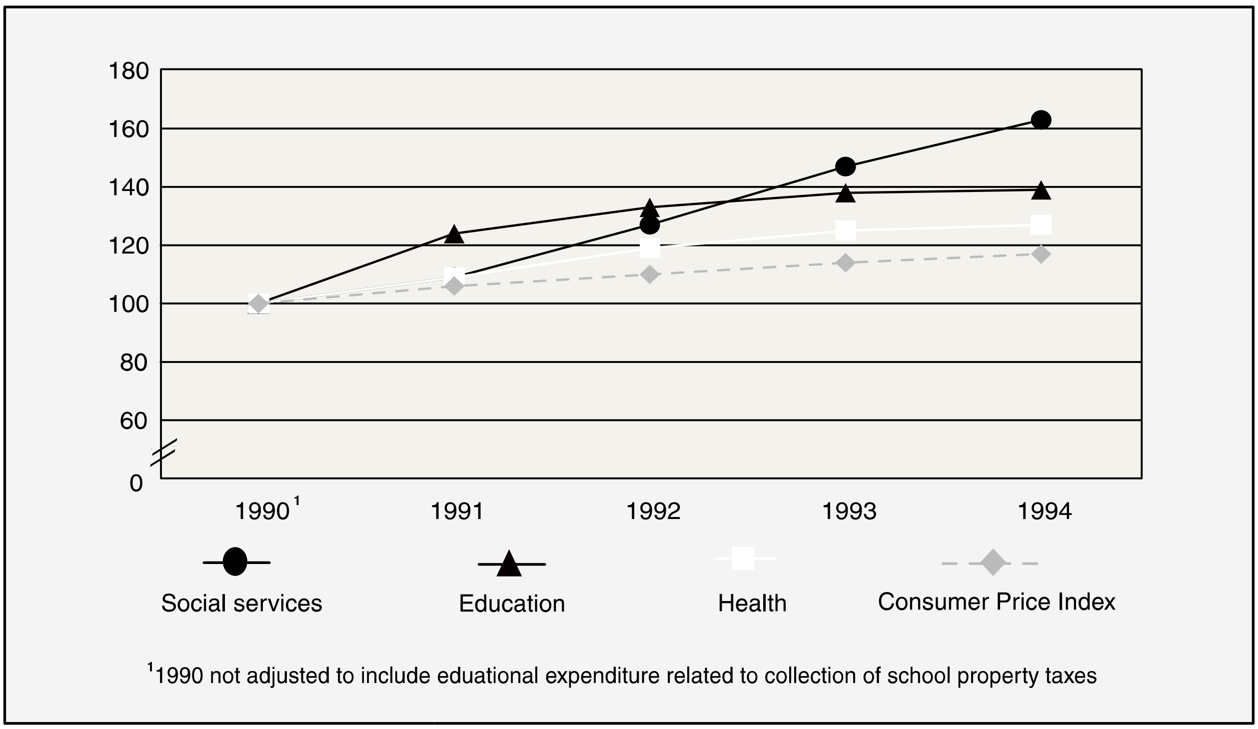
Exhibit 5.6 shows the rate of change in per capita expenditure over the last five years for social services, education, and health. These three functions together accounted for 69% of the province's expenditures in 1994 (68% in 1993).

To show the change over the five–year period, the per capita expenditure in each category has been indexed to the year 1990. The expenditure is in actual dollars and has not been adjusted for inflation. However, the British Columbia CPI is plotted in Exhibit 5.6 to show the general increase in prices in the province, indexed to 1990, for comparison purposes. The information has not been adjusted for the change in administration of school tax, which is explained in our discussion of Exhibit 5.2. Of the total increase of $880 million in education expenditure between 1990 and 1991, $307 million is attributed to this change.

Exhibit 5.6

Change in Expenditures, 1990 to 1994

Rate of change in per capita expenditure for social services, education, and health, and in the Consumer Price Index, (1990 = 100)



Source: The Public Accounts for financial figures, Statistics Canada for population statistics and Consumer Price Index

This section is continued in Section 8b (Financial Highlights).

Click here to proceed to Section 8b.

This section is continued from Section 8a.
(Financial Highlights)

Deficit

The consolidated net expenditure (known as the annual deficit) of the province—the excess of expenditure (operating and capital) over revenue—is an important indicator of the province's financial performance. The annual deficit for 1994 was $904 million, or 5% of the year's total revenue of $19.4 billion. This was a 42% reduction from the $1.5 billion deficit recorded for the previous year. The accumulated deficit of the province—the total of all government deficits and surpluses to date—amounted to $7.4 billion at the end of the 1993/94 fiscal year.

In addition to debt and accumulated deficit, a third financial indicator was added to the financial statements this year: net liabilities.

The term "net liabilities" represents the difference between total liabilities and financial assets. In order to pay our liabilities when they come due, we will need to finance this difference by having either future revenues in excess of expenditures (surpluses) or increased borrowing (debt). Net liabilities amount is an indicator of the province's financial indebtedness.

Exhibit 5.7 shows changes in British Columbia's accumulated deficit over the past five fiscal years.

Exhibit 5.8 provides additional information on the accumulated deficit and net liabilities over the past five years. During this period, the accumulated deficit increased by 286% from $1.9 billion to $7.4 billion, and the net liabilities increased by 169% from $4.4 billion in 1990 to $11.9 billion in 1994.

Exhibit 5.9 shows the rate of change in the province's GDP compared with the rate of change in accumulated deficit at each fiscal yearend, 1990 to 1994, indexed to 1990. During this period, the accumulated deficit increased by 286%, compared to the GDP which increased by 19% and the population which increased by 9%.

Exhibit 5.7

Accumulated Deficit, 1990 to 1994

Accumulated deficit over the past five years ($ Millions)

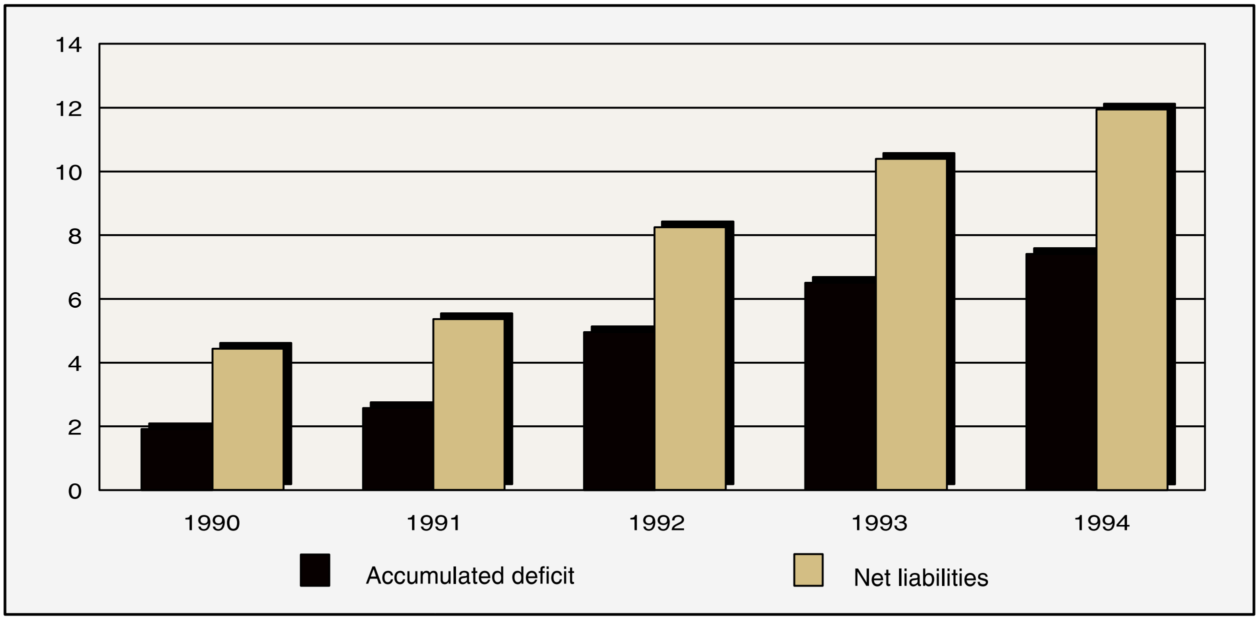
Year ended March 31	1990	1991	1992	1993	1994
Accumulated deficit, beginning of year	(2,432)	(1,918)	(2,570)	(4,955)	(6,502)
Surplus/(deficit) for year	514	(652)	(2,385)	(1,547)	(904)
Accumulated deficit, end of year	(1,918)	(2,570)	(4,955)	(6,502)	(7,406)

Source: The Public Accounts

Exhibit 5.8

Accumulated Deficit and Net Liabilities, 1990 to 1994

Comparison of accumulated deficit and net liabilities at the end of each of the past five fiscal years ($ Billions)

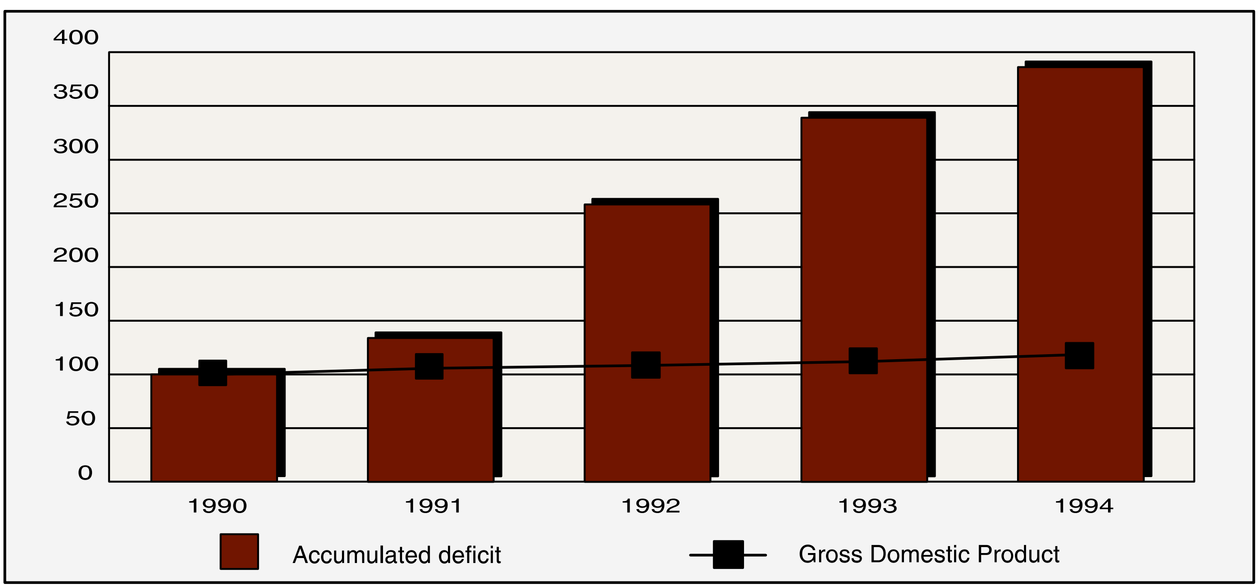


Source: The Public Accounts

Exhibit 5.9

Accumulated Deficit and Gross Domestic Product (GDP), 1990 to 1994

Rate of change in accumulated deficit and in GDP, (1990 = 100)



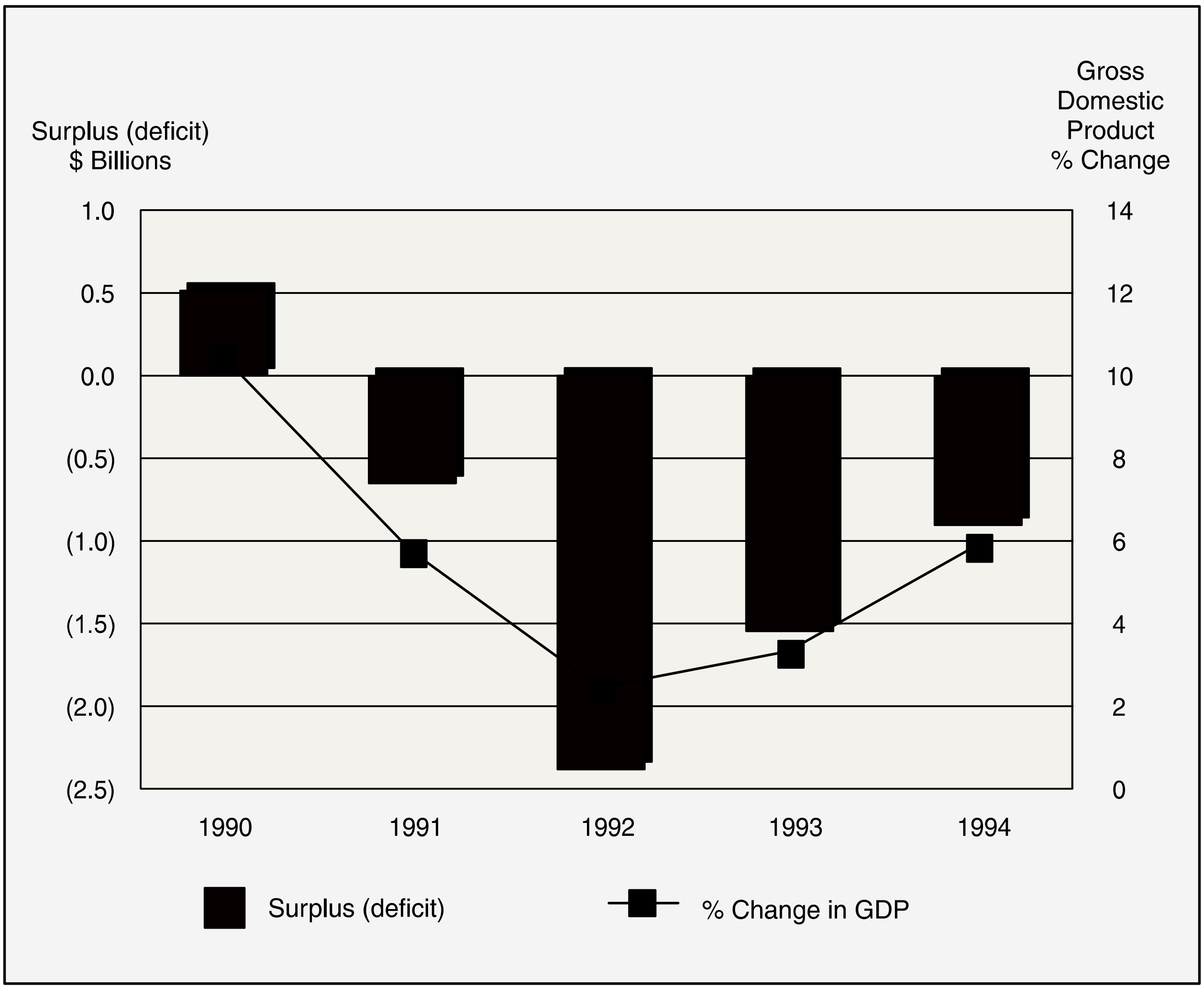
Source: The Public Accounts for financial figures, Statistics Canada for the province's GDP figures

Exhibit 5.10 shows the annual deficit compared to the growth in the provincial economy represented by the percentage change in GDP. From 1990 to 1992, the annual growth in the provincial economy dropped from 10.5% to 2.5%. Also during this three–year period, the annual results of government operations worsened to the point that the government went from a surplus of $0.5 billion in 1990 to a deficit of $2.4 billion in 1992. In 1993, there was a 0.8% increase in economic growth, and a smaller deficit compared with that in 1992. In 1994, economic growth increased from 3.3% to 5.9%, and the deficit decreased from $1.5 billion to $0.9 billion.

Exhibit 5.10

Annual Surplus (Deficit) and Gross Domestic Product (GDP), 1990 to 1994

Annual surplus (deficit) compared to percentage change in GDP for each of the past five fiscal years



Source: The Public Accounts for financial figures, Statistics Canada for the province's GDP figures

Public Debt

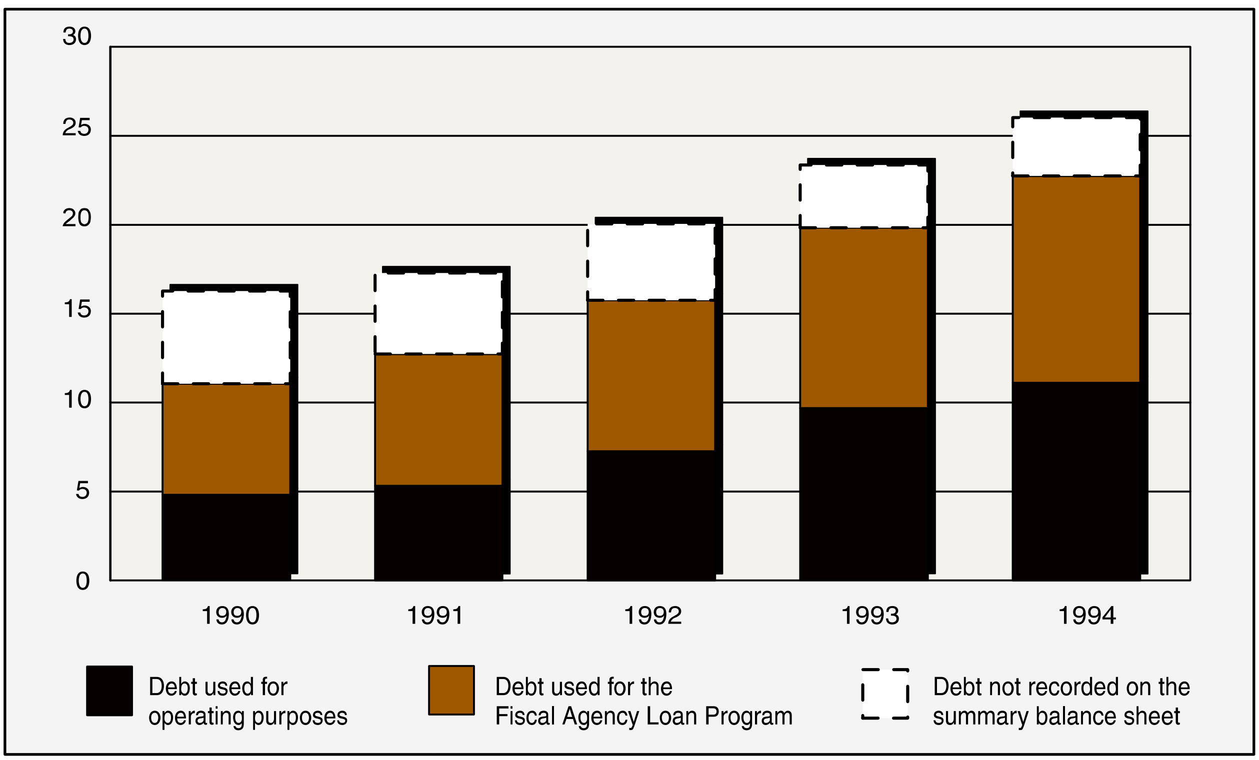
The province has been borrowing in the capital market for two purposes: first, for its own needs and, second, to lend funds through its Fiscal Agency Loan Program to various government and other public sector entities. A complete list of the entities receiving funds through the loan program is presented in notes 15 and 17 of the Summary Financial Statements. Loan recipients include British Columbia Transit, British Columbia Hydro and Power Authority, British Columbia Ferry Corporation, school districts, regional hospital districts, and educational institutions.

Exhibit 5.11 shows the amount of public debt, including amounts borrowed by the province's Crown corporations from sources outside the government (not recorded in the Summary Financial Statements), at March 31 for each of the years 1990 to 1994. During the last five years, the total funds borrowed by the province increased from $16.3 billion in 1990 to $26.0 billion in 1994, an increase of 60%.

Exhibit 5.11

Total Public Debt, 1990 to 1994

Debt by category, including debt not recorded in the Summary Financial Statements, over the past five fiscal years ($ Billions)



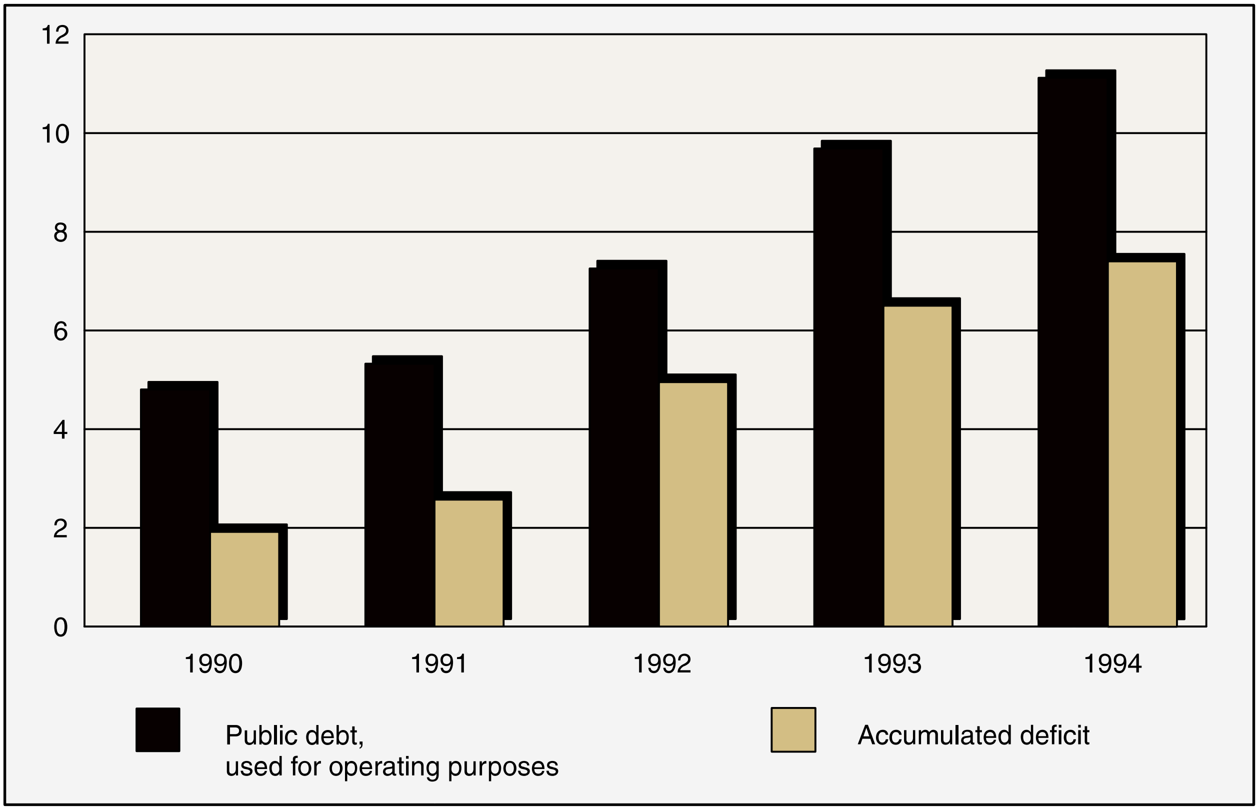
Source: The Public Accounts

Exhibit 5.12 shows the balance of moneys borrowed for government operating purposes at the end of each of the last five years, compared with the accumulated deficit balances at the same dates. The province's debt for operating purposes exceeds the accumulated deficit. In addition to financing its deficits, the government uses borrowed funds for other purposes, such as financing increases in temporary investments.

Exhibit 5.12

Operating Debt and Accumulated Deficit, 1990 to 1994

Comparison of public debt used for operating purposes and the accumulated deficit at the end of each of the past five fiscal years ($ Billions)



Source: The Public Accounts

New Corporate Accounting System: Update

Office of the Comptroller General

An update on the review of the development of the government's new accounting system, including the adequacy of internal controls

Review Purpose and Scope

Last year we assessed the controls built into the government's Corporate Accounting System (CAS). We commented on the integrity and accuracy of transactions processed by it for the Office of the Comptroller General (OCG) and a few pilot ministries. We also commented on the system development process.

The development of CAS is still continuing. Given the concerns we raised last year, we conducted a follow–up review in October 1994, obtaining information from both the OCG and CAS project management and reviewing external and internal reports. In this report, we re–examine our concerns and comment on the current status of the project.

Overall Conclusion

Over the past year, there have been no significant additions or enhancements to CAS, with the old central batching system still being used to process the bulk of the government's expenditure transactions. The new system continues to be used by the same few pilot ministries, and recently the Ministry of Attorney General has been connected on–line to CAS. Nevertheless, project management has taken several positive and significant steps in response to our recommendations last year and to those of a pilot implementation review conducted by a consulting firm shortly after our review. In our opinion the project is well prepared to proceed.

The project management has developed a comprehensive business case for presentation to Treasury Board. Further progress of the project is now subject to the approval by Treasury Board of additional funding to continue implementation.

Introduction

Last year we reported on the Corporate Accounting System (CAS), which was nearing completion of its first significant phase, under development since 1989. The government is planning to completely implement the system by March 31, 1997. Because CAS will affect all financial transactions and their reporting throughout government, we will be reviewing the project periodically and reporting on its progress. In particular we will focus on the adequacy of the internal controls built into the system, and on the development process. Since the date of our last review, August 1993, several significant events have influenced the development of CAS. Exhibit 6.1 provides a synopsis of these events.

Summary of Findings

Our 1993 report noted weaknesses in several aspects of the project's development process. Below are our findings of how the OCG has followed up on the concerns we raised.

Access Security, Change Controls, and Disaster Recovery

The Information Technology Management Branch (ITMB) of the Ministry of Finance and Corporate Relations reviewed and reported on

Exhibit 6.1

Important Events Affecting the Corporate Accounting System (CAS) Project

Developments in the project since our review of the system in August 1993

1993	**September**	Government re–organization.
	December	Report on the new Corporate Accounting System by the Auditor General.
1994	**January**	Pilot implementation review by LGS Group Inc.
	March	Security assessment of CAS/Walker by the Ministry of Finance and Corporate Relations, Information Technology Management Branch.
	April	Security review of CAS/Walker by the CAS project office.
	May	Approval of CAS terms of reference.
	July	Documentation review by Sovereign Information Systems Inc.
	September	Approval of CAS roles and responsibilities.
		Approval of CAS high level system architecture.
		Approval of CAS implementation strategy.
		Conversion to CAS by the Ministry of Attorney General.
	October	Completion of the final draft of the CAS business case.
		Preparation of the request for funding.

Source: CAS Project Office

the security controls surrounding the CAS / Walker system. ("Walker" refers to the main system software used by CAS.)

The report, issued in March 1994, confirmed our earlier findings that, although adequate controls are in place to establish and monitor user access, the process is weak in those areas where ministry staff lack the training to interpret control reports.

In response to our concern about the inadequate change control procedures, project management introduced a change management process in December 1993, requiring that all changes be authorized by user management before implementation. Subsequently, ITMB reported that it was still concerned that, under pressure, the procedures could be circumvented.

On the adequacy of segregation of duties, the ITMB's review also found instances of individuals having conflicting system access. For example, during staff shortages, some production staff also perform functions of the development staff. This, we feel, increases the risk for unauthorized and uncontrolled changes.

In April 1994, the CAS office conducted its own internal security review to obtain additional information on the concerns identified by both our Office and the ITMB. It looked into the security access of members of the development team and identified several high risk areas. At the time of this update, CAS management is following up on these concerns.

We recommend that CAS management continue to investigate and follow up on access security and change control issues regularly.

In November 1993, the CAS underwent the disaster recovery tests of B.C. Systems Corporation. It was concluded that existing back–up tapes would provide almost complete restoration of function to on–line clients. However, it should be noted that the on–line function of CAS represents only a very small part of the government's overall accounting process.

We recommend that continued consideration be given to establishing disaster recovery procedures for all government accounting stages to ensure business continuity, and that these procedures be formally documented and distributed to ministry staff.

Documentation Controls

Our 1993 report noted inadequacies in the existence or distribution of the following documents:

- system specification documents, for system maintenance;
- operations documentation, for normal system operation;
- batch job documentation, for restart and recovery; and
- user procedure manuals, for training and ministry use.

In July 1994, the CAS office contracted Sovereign Information Systems Inc. (SIS) to provide a detailed report on whether the current state of documentation in CAS is sufficient to maintain the system properly. SIS concluded that because documentation standards were either non–existent or not rigorously enforced, many of the documents were inconsistent, incomplete, unorganized, and out–of–date.

As the appointed owners of the new system, OCG is currently attempting to resolve the situation by emphasizing to the development team from B.C. Systems Corporation the need for proper documentation.

We stress again the importance of adequate documentation controls, and support the project management's continued action in this area to bring existing documentation up to standard.

Testing Controls

The following steps and procedures have been implemented since our last review to ensure that computer applications, enhancements, and new releases are subject to appropriate, complete, and objective evaluation of their ability to handle all situations correctly. To ensure that all identified deficiencies are reviewed and resolved before implementation, the following have taken place:

- **Acceptance and sign–off**: No new applications are put into production without the approval of the "owners." The owners will not give approval without the users' acceptance.
- **Quality assurance**: A Quality Assurance Checklist must be completed by the Quality Assurance Administrator to ensure that all stages of the development process, including testing, meet the stated standards.

Implementation of sign–off and quality assurance procedures has started. Its successful completion will address our recommendation that all new or changed applications be sufficiently tested and properly accepted by the system's users.

Communication Procedures

In line with our concerns over the adequacy of communication procedures, the January 1994 pilot implementation report cited weak procedures for building stakeholder acceptance as being a serious risk to project success. The report reiterated the importance of communication in earning the confidence, and therefore the commitment, of all ministries.

A draft strategy has been developed to address communication among OCG, the CAS project group, and ministries. The proposed strategy outlines details of specific procedures and ways to evaluate its effectiveness.

Approval and implementation of this strategy will resolve our concern over the lack of communication procedures for a project such as CAS.

Implementation Procedures

We made several comments in last year's report about the project's implementation procedures. Our follow–up findings are summarized below.

Formal sign–off and acceptance

The OCG, represented by the Director of Financial Management Branch, has been appointed as the owner of CAS. All results from each stage of development must now be accepted by the owner's representative. The documents we reviewed were all properly approved.

Contract pricing

The newly restructured organization of the CAS project now relies more heavily on the Ministry of Finance and Corporate Relations' own staff resources, and less on B.C. Systems' contracted management services. Therefore, fixed-price contracts—a concern we raised before—are not expected to create as much of a problem under the new project structure. To increase its control over the cost of the project, the OCG is incorporating penalty clauses into its contract agreements.

Costs and benefits analysis

In our last report, we recommended a post–implementation analysis of the developed phases of the system to look into costs and benefits of continuing the project. The January 1994 pilot implementation review provided such an analysis of the costs and benefits of the project, based on factors as they existed at the time of that review. The following preliminary estimates were given, although it was stressed that they would be inconclusive until certain important decisions about the direction of the project were made:

- Start–up and pilot installation cost to January 1994: actual, $11 million.
- Restructuring and ministry implementation: estimate, $18 million.
- Net annual operating savings, after full implementation: estimate, $1 million.

Now that the direction of the project is clarified, the CAS project group has updated the analysis of costs. This "business case," which is pending final approval by the project's steering committee, will form the basis for a submission to Treasury Board requesting funds for further implementation and operating costs. The business case assumes a period of four and a half years, October 1, 1994, to March 31, 1999. The first two and a half years would be for implementation; the remaining two years would reflect government–wide operations after full implementation. Exhibit 6.2 summarizes the cost / benefit analysis and shows that the net benefit of CAS is estimated to be $19 million over the four and a half years.

Project Funding

The budgeted direct expenditures for CAS for the 1994 / 95 fiscal year are $5,614,000. This amount provides only for the continued operation of the project in those ministries already on CAS. Additional funding will be determined once Treasury Board responds to the request for funding. The Treasury Board submission is expected to be made by the end of November 1994.

A document titled "Responsibilities with Respect to the Corporate Accounting System" clearly specifies which costs are to be covered by the ministries and which are to be covered by the OCG.

Exhibit 6.2

Estimated Total Quantifiable Costs and Benefits of the Corporate Accounting System Over the Next Four and a Half Years

Estimated costs and benefits of CAS, October 1, 1994, to March 31, 1999

	$ Million
Development and implementation costs	8.7
Operating costs	40.4
	49.1
Benefits	67.8
Net benefit	18.7

Source: CAS Project Office

Phased vs Single Step Implementation Approach

In January 1994, the pilot implementation review confirmed and expanded on our recommendation that a phased approach be adopted to implement CAS. The report stated that: "CAS is more of a vision than a project. It is too broad in scope and time to be managed as a single project. It should be restructured into a strategy that is comprised of smaller more definable and controllable projects that are funded on a fiscal basis."

A phased approach has been adopted to implement the improved version of CAS. Work will concentrate on converting ministries to CAS as they become ready. The Ministry of Attorney General is the first coming on–line in September 1994.

An implementation schedule details the order in which ministries will be brought on–line. The schedule was drawn up according to the "type" of ministry, and to the number and nature of technical differences that exist between CAS and the system already in place in the ministry. The ministry's type depends on whether the ministry's financial information system is dependent on its program financial systems.

Future Direction

The pilot implementation review established the OCG's commitment to CAS, and concluded that the system must be either further developed or else replaced by a new system. The report also identified three primary risks that could harm the project:

- stakeholder acceptance,
- project funding, and
- architectural structure and capacity.

One of the most significant stumbling blocks observed during our last review was the lack of an overall plan—including an architectural strategy—of the whole system. In September 1994, such a strategy received final approval. In addition to this improvement, certain modifications have been made to CAS to address capacity concerns, and the issue continues to be among the project's priorities. According to the implementation strategy, all ministries are to be on CAS by March 31, 1997. Exhibit 6.3 shows an overview of the current structure of the financial systems of the B.C. government and that of the completed CAS.

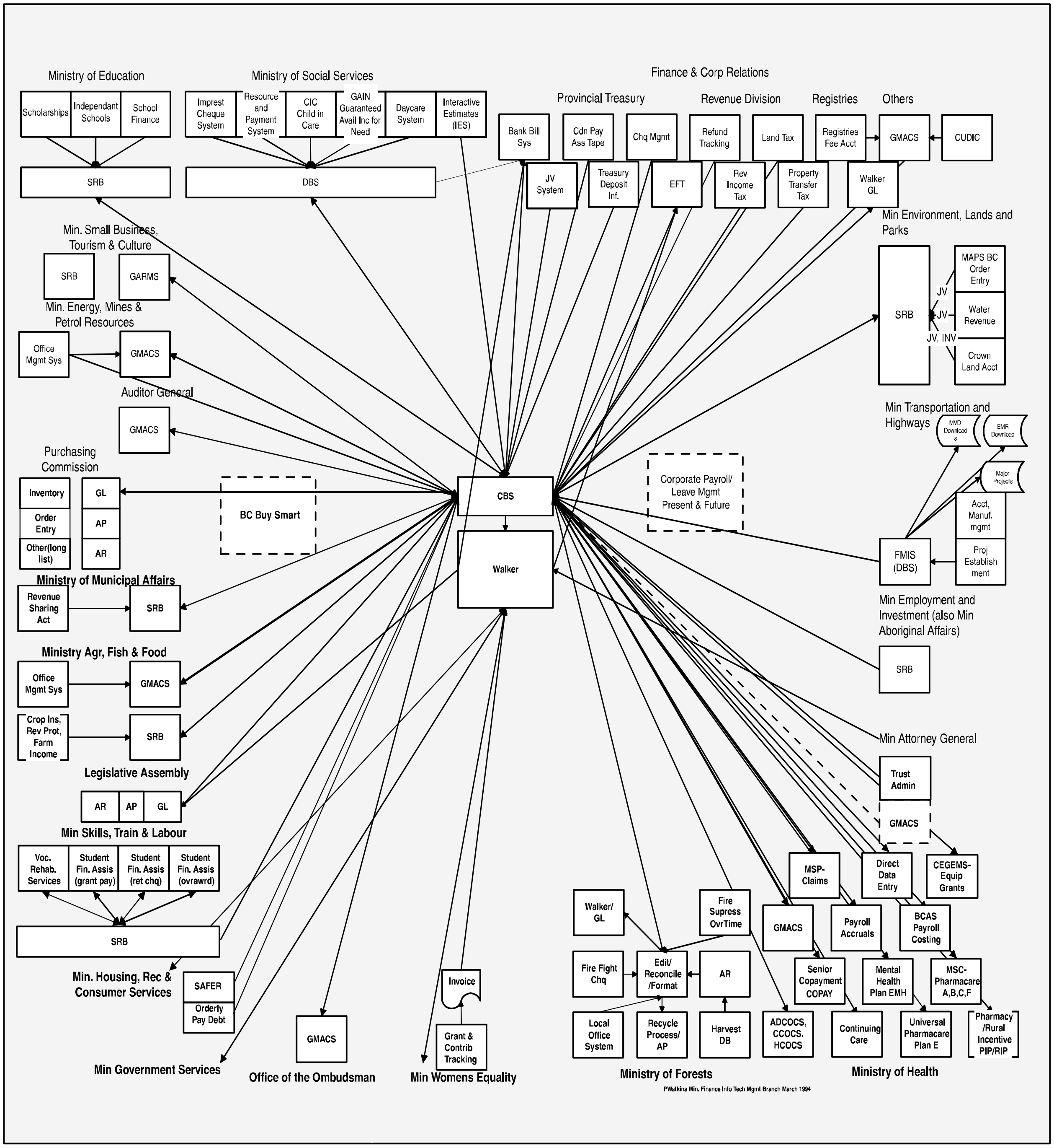
We believe that project management has addressed the primary risk areas referred to above. This should allow the government to make an orderly move from its current financial accounting structure to the one originally envisioned in the government accounting system strategic plan over five years ago.

We plan to revisit the development of CAS periodically and to continue to report on its progress, especially with the implementation phase of the system. We commend the OCG for its efforts in responding to the concerns we expressed in our 1993 report, and for its achievement over the past year in moving towards a new accounting system.

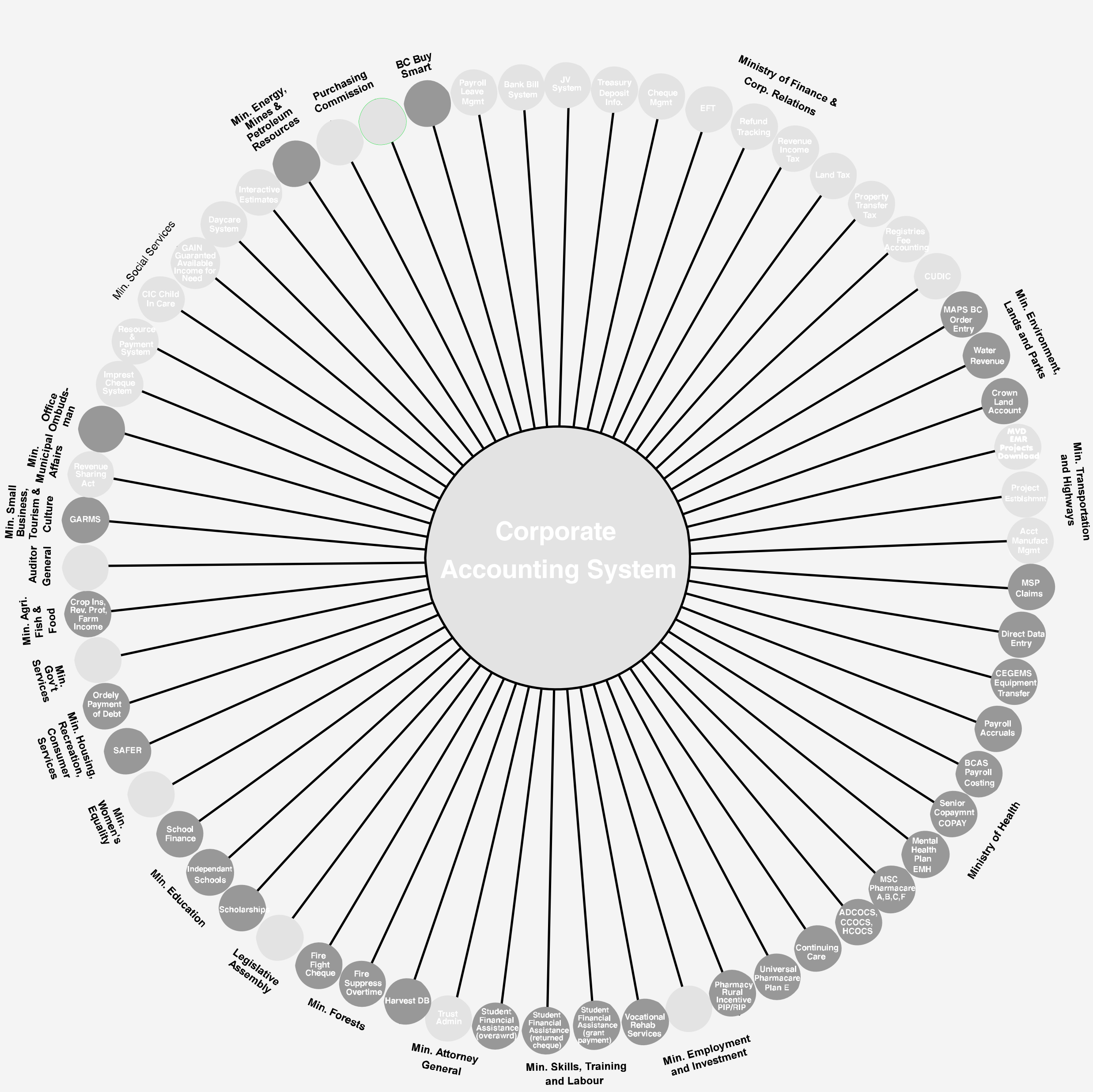
Exhibit 6.3

An Overview of the Financial Systems of the Government

The current financial accounting structure compared with a vision of the completed Corporate Accounting System



CORPORATE ACCOUNTING SYSTEM VISION



Source: CAS project management

Response of the Office of the Comptroller General

New Corporate Accounting System: Update

The Office of the Comptroller General agrees with the recommendations of the Office of the Auditor General. Subject to resource constraints, it is the intention of the Office of the Comptroller General to continue to address the issues raised by the Office of the Auditor General.

Public Funding of Non–government Organizations

Section contents

Public Funding of Non–government Organizations

A review of controls surrounding various contributions and grants paid to non–government organizations by government ministries

Review Purpose and Scope

We undertook this review because of the significance of government funding to non–government organizations and because of the irregularities we identified in a companion report, "Public Funding of Non–government Organizations Through the Sale of Breakopen Lottery Tickets" (page 99). In that report we noted public funds being paid to ineligible organizations, and monitoring procedures failing to determine whether the funds are actually spent on approved purposes. Based on those results, we believed that there was a risk that similar problems could exist in other government contribution and grant programs.

Our purpose in this review was to determine whether ministries had established procedures to ensure that expenditures were approved only for organizations eligible for funding, for the purposes established, and that the funding was used by recipients only for the purposes approved. Our review focused on the procedures that the ministries put in place to assess requests for public funding, approve funding, and monitor funding use.

We conducted the review between January and July 1994, looking at the contribution and grant payments made to organizations during the 1992/93 fiscal year. This timing enabled us to review the funding process from initial acceptance of the requests to the final reporting by the recipients. Recipients include, for example, libraries, health care centers, theaters, nursing homes, and agencies providing community support services.

We looked at a sample of payments in excess of $44 million, made from 82 programs in 11 ministries, and examined relevant ministry documents and records. We also discussed the administration of the programs with key ministry officials. We did not visit any of the recipient organizations.

Overall Conclusion

In 1992/93, approximately $1.5 billion was paid to non–government organizations to assist government in providing services to the public. Such a significant outlay of public funds is likely to continue and it is therefore important that the government manage these payments with the same diligence as it does other expenditures.

Overall, we concluded that although many good procedures exist for assessing eligibility, significant improvements in controls over this outlay of public funds are required. In particular, better assessment of the financial requirements of non–government organizations is needed before requests are approved, followed up by better assessment of the actual costs incurred by funding recipients.

Key Findings

Guidance on How to Submit a Request for Funding Was Adequate

We found that the ministries have provided adequate guidance to organizations wanting to submit requests for funding assistance. Program guidelines generally contained information about funding availability, eligibility requirements, and the funding process. This type of information encourages as many eligible organizations as possible to submit requests so that available funds can be targeted to best effect.

As well, ministry programs have well–defined eligibility criteria that must be met before there is any further assessment of the request. These criteria allow the ministries to assess whether the non–government organization making the request qualifies, and whether the request is consistent with the overall objectives of the program. This process helps prevent time being spent on requests that are not eligible for assistance.

Assessments of Funding Needs Were Not Well Documented

Ministries request basic financial information to be submitted with funding requests. This information allows the appraisers to assess the funding needs of the organization and to determine if the project could proceed without assistance.

We found that, in most cases, appraisers were given little guidance on how best to perform these assessments. Furthermore, the assessments done were seldom supported by sufficient information to justify the funding decisions.

Monitoring of Spending Was Generally Inadequate

Effective monitoring procedures are essential for determining if public funds have been used for approved purposes. Valuable information, such as the level of success of the program and the validity of the actual costs, can be gained through the monitoring process and may help shape future funding decisions.

Overall, we found that most contribution and grant programs did require that non–government organizations submit financial information to support the use of public funds, but that the information received was generally inadequate to enable the reviewer to determine what the actual costs were. In addition, procedures to deal with overfunding of program costs were inadequate.

Background

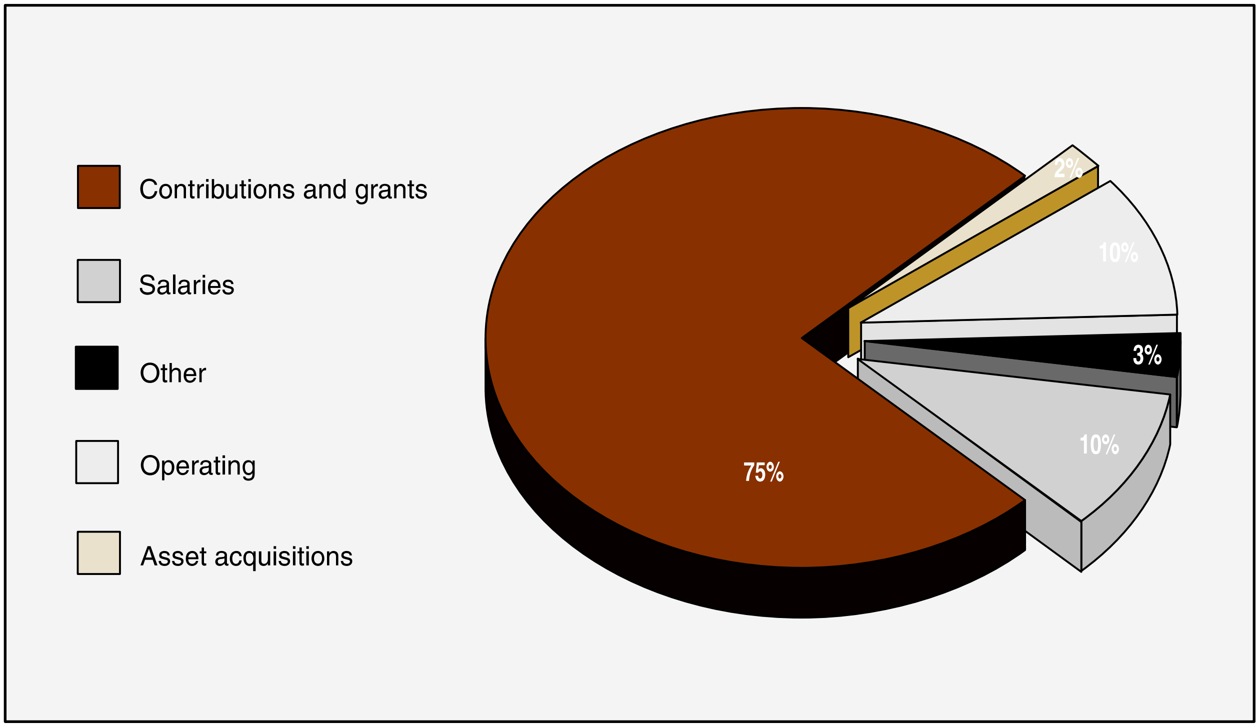
The provincial government provides significant public funding to both non–government and government organizations in the form of contributions and grants.

In 1992/93, Consolidated Revenue Fund expenditures were about $18 billion. Contributions and grants were $13.5 billion, or 75% of this total (Exhibit 7.1). This percentage has remained consistent for the past five years.

Approximately $12 billion of these contributions and grants

Exhibit 7.1

1992/93 Consolidated Revenue Fund Expenditures



Source: The Public Accounts 1992/93

went to municipal governments, hospitals, schools, Crown agencies, and income support programs. The other $1.5 billion—and the focus of our review—went to non–government organizations. That money supports many programs by funding, for example, operating costs for theater groups, construction costs for arenas and swimming pools, wage supplements for child care workers, and residential care and housing costs for the elderly. These non–government organizations operate predominantly on a not–for–profit basis.

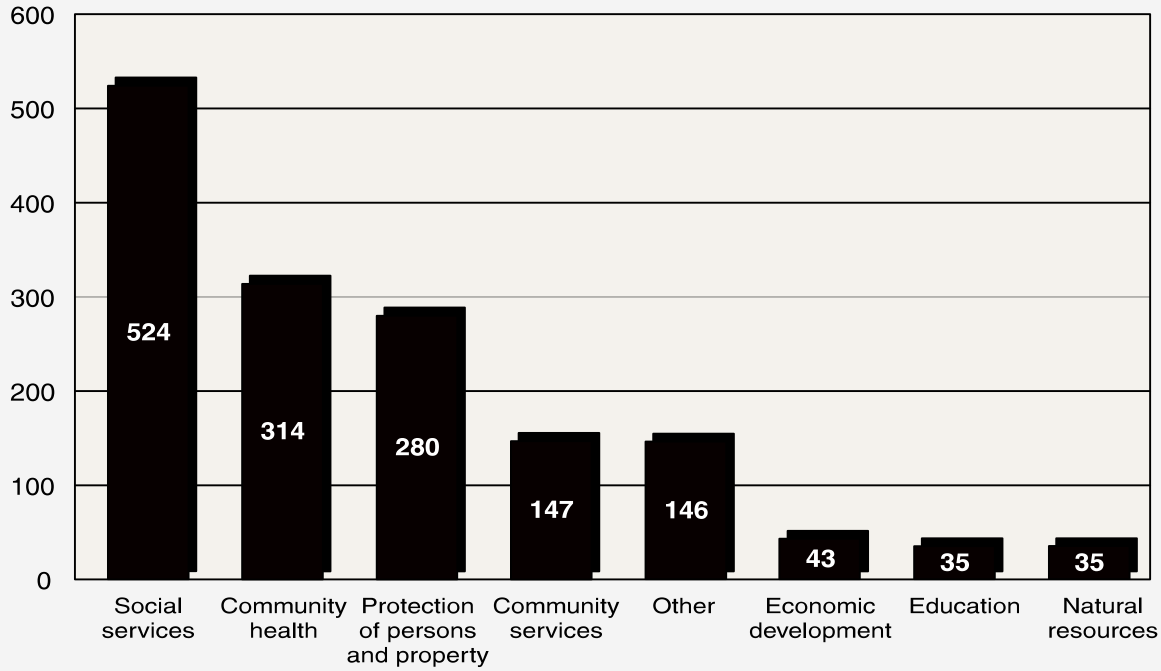
Exhibit 7.2 shows the general purposes of the $1.5 billion paid out by the government in contributions and grants to non–government organizations.

This graph was developed from our review of the 1992/93 Public Accounts. Some examples of the programs funded in each category are included below.

- Social services – family support, child care, programs for mentally handicapped adults.
- Community health – family and preventive health, mental health.
- Protection of persons and property – correctional centers, probation services.
- Community services – libraries, amateur sports and community capital projects.

Exhibit 7.2

Contributions and Grants to Non–government Organizations by Purpose
($ Millions)



Source: The Public Accounts 1992/93

- Other – housing, tourism, and cultural activities.
- Economic development – support to businesses to pursue development opportunities.
- Education – training and rehabilitation initiatives, initiatives to enhance student performance.
- Natural resources – support for agricultural businesses and waste management initiatives.

Funding of Organizations

Non–government organizations receive their funding in a number of ways. They may charge fees (admission to events) or they may receive donations from corporations, individuals, and other organizations. Most often, however, their primary funding is from federal, provincial, and municipal governments.

The ways the province funds organizations is also diverse. In addition to the $1.5 billion it pays directly to these organizations, it makes funds available through various government agencies. It also provides over $100 million yearly by granting non–government organizations licenses for public gaming (bingos, casinos, and ticket raffles).

Exhibit 7.3 illustrates how non–government organizations can access public funds, either directly or indirectly.

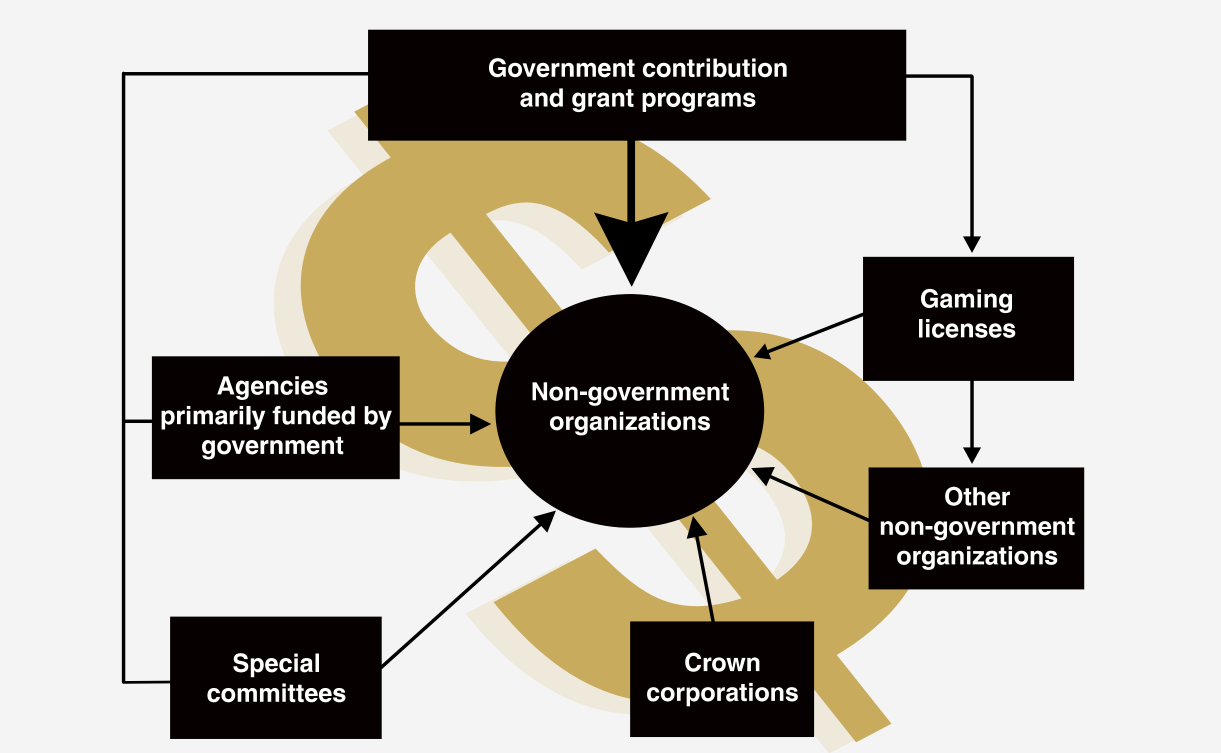
How the Contribution and Grant Process Works

The process for transferring public funds through a contribution or grant program generally has four stages: planning, operation, monitoring, and evaluation (see Exhibit 7.4).

Although the planning and evaluation stages are important because they help to ensure that aims

Exhibit 7.3

Sources of Government Funding Available to Non–government Organizations



"Agencies primarily funded by government," such as school boards.
"Special committees," such as the B.C. Aboriginal Health Council.
"Crown corporations," such as B.C. Hydro and B.C. Lottery Corporation.
"Gaming licenses," such as bingos, casinos, and ticket raffles.

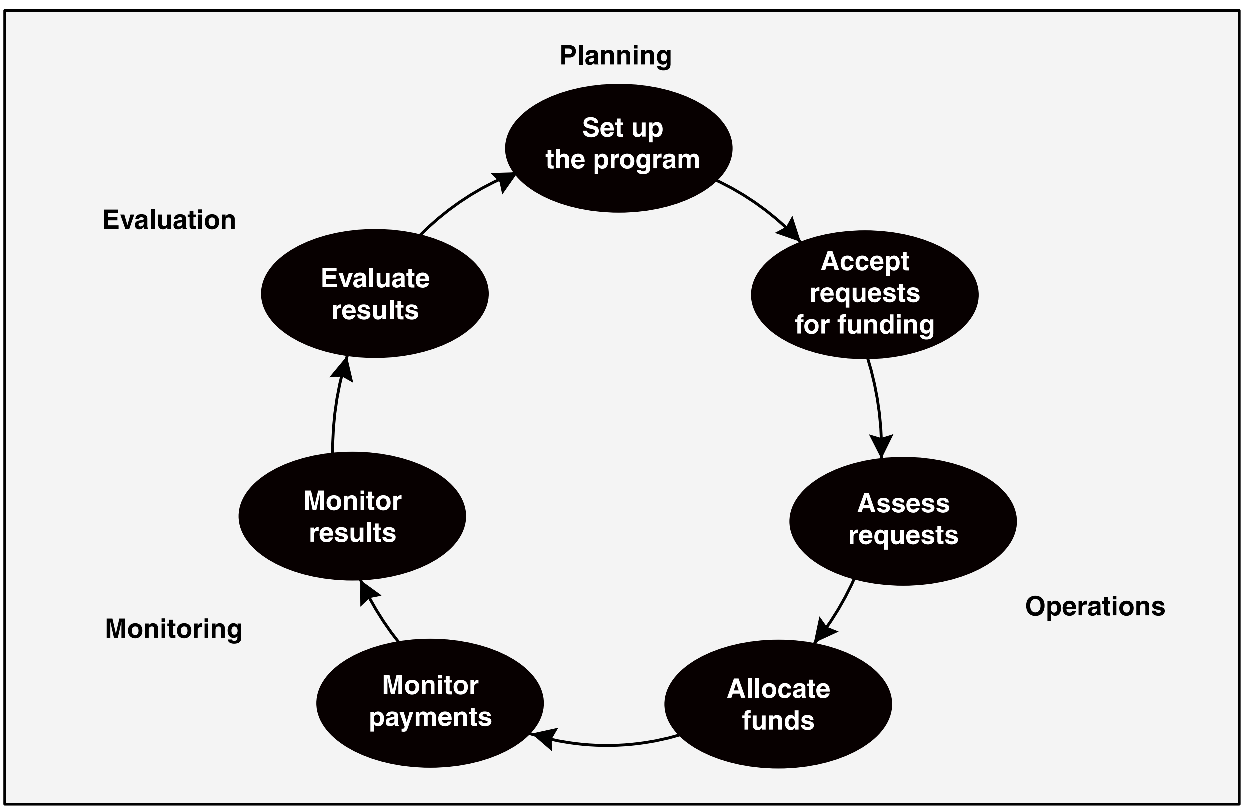
and objectives of the program are met, these were not the focus of our review. Our interest was in the processes essential to approving contributions and grants—the operation stage—and the subsequent monitoring of the expenditures.

The operation stage of a contribution or grant program includes the processes of *accepting* requests, *assessing* them, and *allocating* the funds to the successful applicants. These processes are needed to ensure that appropriate funding decisions are made and will contribute to the success of the program. At the same time, however, all of these processes must be flexible and responsive to lessons learned from monitoring of completed projects.

Effective monitoring is also an essential element of control in any contribution or grant program. It should provide assurance that conditions attached to the funding have been kept, and that the objectives of the program have been met. In this way monitoring can be used as the basis for making improvements or confirming success.

Exhibit 7.4

The Contribution and Grants Process



Accepting, Assessing, and Approving Requests

In the operation of a contribution and grant program, procedures for accepting funding requests, assessing them, and allocating funds are necessary to ensure that the organizations and projects selected are those most likely to achieve the program objectives.

We expected to find information that provided guidance to both the ministry and the non–government organization. For the organization it would include information about available funding, eligibility requirements, and the funding process. For the ministry, it would include a clear description of the objectives, priorities, and funding policies. We also expected the ministries to have established

The Infant/Toddler Incentive Grants Program stabilizes and increases the number of safe, affordable, licensed child care spaces for infants and toddlers. Incentive grants are provided to all eligible licensed group centres and licensed family providers who enrol infants and toddlers.

• WHO IS ELIGIBLE TO APPLY?

Group Day Care Under 36 Months

Any centre licensed to provide care for children under the age of 36 months, or with a license pending on April 30, 1992, is eligible for an operating grant of $5 per day per occupied, licensed space. The licensed spaces may be filled by children attending on either a full-time, part-time or drop-in basis. As of May 1, 1992, only new, non profit centres are eligible to apply.

Licensed Family Day Care

Family care providers who are caring for children under the age of two, are eligible for an operating grant of $3 per day per occupied space, to a maximum of two spaces, as designated by the Child Care Regulation. The spaces may be filled by children attending either full-time, part-time or drop in.

• WHAT ARE THE APPLICATION REQUIREMENTS?

Group Day Care Under 36 Months

Non profit programs, which are operated by a registered society in good standing with the Registrar of Companies and private programs licensed prior to April 30, 1992, which meet all applicable government requirements, will be eligible for Infant/Toddler Incentive Grants if they meet the following criteria:

- operate under a license or interim permit for Group Care under the age of 36 months;
- operate in accordance with the *Community Care Facility Act* and the *Child Care Regulation*;
- submit a current financial statement upon application and annually thereafter, and;
- submit a copy of the most recent Facility Inspection Report.

Licensed Family Day Care

To be eligible for grants, family day care providers must meet the following criteria:

- operate under a license to provide family day care;
- operate in accordance with the *Community Care Facility Act* and the *Child Care Regulation*;
- provide care for children under the age of two;
- be registered with the nearest Child Care Support Program (formerly Day Care Support Program), and;
- submit a copy of their most recent Facility Inspection Report.

• WHAT IS THE PROCESS FOR GRANT PAYMENTS?*

Group Day Care Under 36 Months

Once the application is received in Victoria, the Child Care Branch will verify the non-profit society's status with the Registrar of Companies and the centre's license with the Community Care Facilities Branch. If the application is approved, quarterly payments will be made based on the actual enrolment of the previous quarter.

To qualify for subsequent payments, Enrolment Reports must be submitted quarterly, with enrolment verified by a parent of the enrolled child. Grant payments will be made at the end of each quarter. To maintain the grant, facilities must reapply annually at the end of the last quarter.

Licensed Family Day Care

Once the application is received in Victoria, the Child Care Branch will verify the licensed status with the Community Care Facilities Branch, and confirm registration with the Child Care Support Program. If the application is approved, payments will be made twice a year based on enrolment.

* Please note: The payment process for Group Day Care differs from that of Family Day Care

Ministry of Women's Equality

processes to assess the funding requests for eligibility, as well as selection criteria to rank the applications.

Overall, we found that a lack of documentation and financial expertise throughout the process made it difficult to determine whether the funding decisions were appropriate.

Accepting Funding Requests

We looked at the information ministries provide to organizations to make them aware of what government funding is available, how to access it, and what information must be submitted with a funding request. Information we expected ministries to request of non–government organizations includes a description of the organization, a description of the project, and basic financial information, such as a project budget and a certified financial statement.

In the programs we reviewed, we found that although the information requested was not standardized, it was generally sufficient to enable non–government organizations to apply for funding and to enable the ministries to start assessments of the funding requests.

Assessing Funding Requests

As ministries generally receive more requests for funds than there are funds available, choices must be made. These choices are based not only on what the funds are requested for, but on what the eligibility and funding needs of each organization are.

Eligibility criteria

We expected ministry programs to have eligibility criteria with which to determine those organizations that meet the ministry's requirements and those that don't. For example, to qualify for assistance, in one program, independent filmmakers must show they have completed basic film training, demonstrate editorial control over their project, identify all funding sources, and certify that the project is not primarily for theatrical or prime time television release.

We found that the programs generally had well–defined eligibility criteria. However, we also noted in our examination of approved requests that the assessment of an organization against these criteria was not always documented. As a result, it was often difficult to determine how the ministries had made their decisions on the eligibility of applicants.

We recommend that all ministries document the information on a checklist which, when completed, would show whether or not the non–government organization had met the eligibility criteria.

Review of financial data

The ministries also need to assess how much funding an organization requires. For this they need enough information to determine the reasonableness of the budget, and the financial needs of the organization, including details of other funding sources.

Is the project budget reasonable?

The budget, as the basis on which the ministry determines whether the requested funds are appropriate for the work to be undertaken, must be carefully reviewed for reasonableness. In regard to repeated funding, this would include comparing the current year's request to the prior year's financial information and the results of previous funding. Procedures for new or specific programs would vary depending on the nature and amount of the funding.

Although we were informed reviews were normally carried out, we found that results of such reviews were generally not documented. When we looked at the financial information submitted to support requests, we sometimes found it difficult to determine why the amount requested was approved. For example, we found one organization that allocated $97,450 in telephone expenses over its 74 programs. However, actual audited telephone expenses included in its submitted financial statements were only $52,856. This discrepancy should have been found in a review of the financial information, but there was no indication that it had, or that it had been considered when the funding amount was determined.

We noted that the nature of information submitted to support funding requests was complex and that to perform these reviews required financial expertise. We were informed by some staff that they felt they lacked this knowledge.

We believe that if an adequate review of budget and other financial information is to be made, ministries need to establish procedures that ensure that those reviewing budgets have access to staff with financial expertise. As well, because the funding is based on the budget, we believe the results of the budget reviews should be documented.

What are the funding needs of the organization?

In ministry assessments of whether government funds should be provided to the non–government organizations, we expected the funding needs of the organizations to be a relevant factor in determining their eligibility. The question is: how much funding is required to start the project and successfully complete it?

In fact, we found that the financial need of the organization was seldom a consideration in the funding decision. Although, we noted some examples of funding being reduced as a result of a surplus, we also found examples where it was not. In one case, for example, even though a regional manager had noted on the application that the organization was capable of performing the service without public assistance, the organization still received the requested funding. There was no indication in the files as to why this happened. In another case, an organization reported a surplus of over $137,000 on its financial statements for 1992/93 and still received an increase in its 1993/94 funding.

We recommend that the funding needs of the organizations be a criterion in determining the amounts funded, and that funding decisions be supported by written assessments of funding needs.

Does the organization have other funding sources?

Government provides funding through many ministries and agencies, and non–government organizations are often eligible to be funded from a number of these sources. This means there is a risk of overfunding by the government. We found that although most ministries required organizations to identify their funding sources, they were usually not checked. A theater company, for example, received funding from three separate ministries, a regional Health Council, an arts festival, and a school board—all for the same project. On inquiring about this we noted some of the funding sources were unaware of the others. Without knowledge and a review of all government funding to an organization, it is possible for government funding to exceed what might otherwise be deemed reasonable for the organization's needs.

We also found one government program that did not require the non–government organizations to identify funding from other government sources. As a result, several non–government organizations received duplicate funding for the same program.

We recommend that procedures be established that enable ministries to co–ordinate their efforts and ensure that government funding sources of non–government organizations are checked. Consideration could be given to using information currently available in the central accounting system of the government. We also recommend that all requests for funding require non–government organizations to disclose other sources of government funding.

Allocating Funds

Selection criteria

Many government programs receive requests for funding which total more than the funds available. Decisions must therefore be made as to which organizations are to receive funding and in what amounts. To make an equitable allocation of funds, ministries need to rank applications against clear selection criteria. These might include the organization's prior experience, its reputation and technical ability, and the qualifications of its staff.

We found that although programs generally had clearly defined selection criteria, it wasn't always clear from the files we reviewed why one application was successful and another failed.

We recommend that the reasons for acceptance or rejection of funding requests be documented in the funding files as support for the funding decision.

Funding agreements

Funding agreements are a crucial part of any contribution or grant program. They specify the manner in which funds are to be used and the reporting requirements of the recipients on how they used the funds. In order for the government to be able to check the use of government funding, the agreements should state the ministry's right of access to the non–government organization's records and set out the ministry's expectation for recovery of any overfunding.

Most agreements we examined included the ministry's right of access to the service provider's records, but only one–quarter of the funding examples we reviewed dealt with overfunding and made any provision in their agreements for the ministry to recover funds.

We recommend that all funding agreements make provision for the recovery of funds unspent, or spent for purposes other than those approved.

Monitoring the Use of Funds

With significant amounts of public funding being provided to non–government organizations through contribution and grant programs, it is essential that the government establish effective procedures for monitoring whether these funds are being used for their intended purpose. The extent and frequency of monitoring should vary according to the nature of the program, its method of funding, the amount of the funding, and the risks or sensitivity associated with the funding. However, in order for the government to be able to carry out its financial monitoring of contributions and grants, we expected to find:

- requirements for organizations to report sufficient, relevant, and reliable evidence of costs incurred, on a timely basis;
- review procedures to ensure funding was spent for approved purposes; and
- procedures for dealing with any overfunding identified.

Reporting and Reviewing the Use of Funds

An important aspect of monitoring is to ensure that the organizations provide financial information to support their use of public funding. It is also important that ministries review this information and provide assessments of it in the funding files.

We found that the requirement to report financial information varied greatly from program to program, both within a ministry and between ministries. In some instances there was no requirement to report; in others there was a requirement to provide ongoing financial information and audited financial statements after project completion. Even when financial information was required, however, it was often vague and incomplete. As a result, the ministries often had little assurance that funds were spent for the approved purposes. One organization, for example, received $30,000 to provide counseling services, which was one of many programs provided by it and funded by the government. Actual costs of the counseling program could not be determined from the financial information provided because the information was for the organization as a whole and not for any one program. Another organization received $20,845 to fund new staff positions. The financial information provided to the ministry did not show what the funds were used for.

In the cases where appropriate financial information was both requested and provided, we further noted that there was usually no documentation of a review. Some periodic financial reports we examined included expenses that were not identified in the original budget. In these cases, we expected to find notes documenting that a review had been done and that either the expenditure had been approved or, if not, what action was to be taken. Rarely did we find any such documentation. For example, one organization received $5,000 to assist with equipment purchases. Although the equipment purchased was different from that specified in the organization's approved funding request, there was no indication in the file that this discrepancy had been queried.

As previously mentioned, some staff reviewing budgets and other financial information supporting funding requests expressed concern to us over their lack of financial expertise. Thus, when we found deficiencies in financial monitoring, it was not unexpected. For example, one organization received $250,000 in three installments over a period of six months. Each of its requests included a list of activities that had taken place, but no financial costs. After the final installment was made, there was no financial information provided to allow the ministry to determine if funds were used for the intended purpose.

We recommend that the financial services division of each ministry provide monitoring staff with guidance and strategies for obtaining financial compliance. We also recommend that a written assessment be prepared to document the results of each monitoring activity.

Taking Action When the Funding Exceeds Costs

Funding decisions are based on budgets of estimated project costs. If actual project costs are less than the amount funded, we would expect ministries to recover the overfunding, or specify how it should be used. Funding agreements generally provide no guidance as to what should happen with excess funds. We came across one community center, for example, that received one–time funding of about $38,000. Our review of the annual financial statements showed that the project had been overfunded by approximately $13,000, an amount which the center transferred to general operations. The ministry, we noted, had made no attempt to recover the excess funds.

We recommend that ministries make every effort to recover overfunding. Only in this way can recipient organizations be held accountable for the use of public funds.

Public Funding of Non–government Organizations Through the Sale of Breakopen Lottery Tickets

A review of the controls surrounding the Community Group Licensee program, a program funded from the net proceeds of breakopen lottery ticket sales

Review Purpose and Scope

We focused on this program for the following reasons. First, we wanted to do a follow–up to a previous review we had reported on in the January 1992 Annual Report of the Auditor General, where we expressed concerns that the grant payments lacked the normal review process typically applied by the responsible government ministry. Exhibit 8.2 provides a summary of that report. Second, while reviewing the significant amounts of one–time grants made to non-government organizations, and given the number and variety of funded organizations, we were concerned that an appropriate level of control had not been established over the transfer of funds to them. Between December 1990 and September 1992, over $15.7 million was distributed under the program to non–government organizations for community projects.

We conducted a review of the Community Group Licensee (CGL) program, and of the one–time grants made to non–government organizations when that program was ended. Our purpose was to determine whether the British Columbia Lottery Corporation (the corporation) and the Ministry of Government Services, Community Grants Branch, had adequate procedures in place to ensure that:

- only eligible non–government organizations received a community group license and the one–time grant; and
- proceeds from the CGL program and the one–time grants were used for approved purposes.

We carried out the work between September 1993 and February 1994. In undertaking our review, we met with the two organizations responsible for the administration of the CGL program and the one–time grant: the corporation and the

Ministry of Government Services, Community Grants Branch. We reviewed the procedures used in:

- assessing the eligibility of applicants, and
- monitoring how the funds were used.

In order to assess whether public funds were used for approved purposes, we made 20 site visits and examined files, records, and other documentation for selected non–government organizations.

Overall Conclusions

The success of any grants program operating in an environment where funds are scarce and demand is high depends on sound eligibility criteria for applicants and controls for monitoring the use of public funds. It is through the eligibility criteria that the government ensures that only eligible organizations having a demonstrated need receive public funds. And it is through monitoring procedures that the government ensures that public funds are spent only on approved purposes within the community.

In the case of the CGL and one–time grant programs, we found that the government had a basic trust that non–government organizations would simply spend funds according to the government's priorities. In fact, many of these organizations are experiencing tough times, and some are tempted to reallocate funds to meet their priorities—not those of the government. In failing to recognize this, the government, we believe, did not establish the level of review and monitoring it should have to ensure that public funds were appropriately allocated.

This could partially have resulted from the government directing the corporation to administer the program as if the payments were commissions. With that approach, different controls were required than those needed for treating the payments as grants. However, these commissions lacked commercial substance and were subsequently determined to be grants.

We believe that it is important to note that many worthwhile purposes may have been served by the program. However, we concluded overall that although the organizations funded may have been broadly defined as "charitable," the charitable purposes for which the funding were requested was often not adequately assessed and the organizations were not funded according to their financial needs. Furthermore, we concluded that the government did not adequately monitor the expenditures made by the organizations to determine whether the funds were actually spent in the community for the purposes approved.

Breakopen Lottery Tickets

Background

Breakopen lottery tickets were introduced in British Columbia in 1987 to provide the government with a new source of lottery revenue. Similar tickets had met with great success in other jurisdictions, and it was hoped that these successes would be repeated in British Columbia.

What Are Breakopen Tickets?

Breakopen lottery tickets are self–contained, instant–win lottery games in which a purchaser buys a ticket and pulls open paper tabs in the hope of revealing winning combinations of symbols. The tickets, sold in adult–oriented social settings (such as bars, bingo halls, and social clubs), are priced at 25 cents, 50 cents, or 1 dollar. The prizes, up to $500, are claimed at the point of sale and paid by the retailer out of the proceeds from the sale of tickets. The popularity of these tickets has increased steadily, with sales growing from $19.4 million in 1987/88 to $138 million in 1993/94 (Exhibit 8.1).

How Are Sales Stimulated?

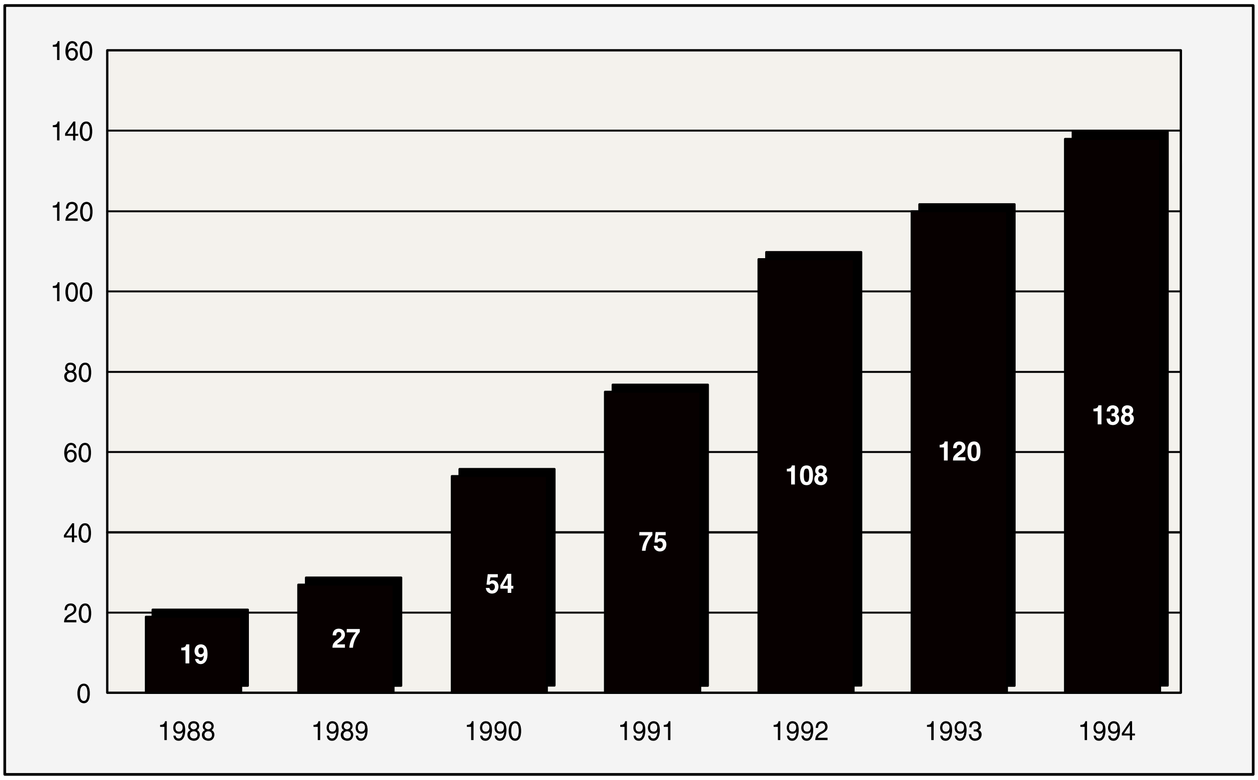
Schemes introduced to stimulate the sale of breakopen lottery tickets have gone through a number of changes since the tickets were introduced to the province. The “Halfback” and the “Community Group Licensee” programs were administered by the British Columbia Lottery Corporation and the one–time grant payout was administered by the Community Grants Branch, Ministry of Government Services.

Initially, the government allowed the retailer (such as pub, bingo hall, or social club) to designate a non–government organization of the retailer’s

Exhibit 8.1

Breakopen Ticket Sales

Growth of breakopen ticket sales since the inception of the game ($ Millions)



Source: British Columbia Lottery Corporation Annual Reports (1987/88 to 1993/94)

choosing to be the recipient of 50% of the net proceeds (gross proceeds less prizes and the retailer's commission). This was known as the Halfback program. The grants were to be used for public service, community benefit, or charitable or religious purposes. Total payments made to non–government organizations through this program to November 30, 1990, amounted to $10.9 million.

The Halfback program was ended because it was a grant program and the corporation did not have a mandate to pay grants.

In December 1990, under direction from the government, the corporation introduced the Community Group Licensee program, which replaced the Halfback program. Under this program, non–government organizations were required to obtain a license from the corporation that would allow them to earn a "wholesale commission" on the retail sale of breakopen tickets. To earn the commissions, organizations were required to find one or more retailers who would buy and sell the breakopen tickets. The government considered the

Exhibit 8.2

Summary of the Previous Report – Unrecorded Lottery Grant Payments

In the January 1992 Annual Report of the Auditor General (pp. 30–31), we reported that the British Columbia Lottery Corporation, the Crown agency responsible for the conduct of lotteries in the province, had made $6.6 million in direct payments to various charitable and community organizations through the Halfback program during the 1990/91 fiscal year. The payments included some of the proceeds from the sale of breakopen tickets, a mini–lottery game marketed and promoted by the corporation.

We found that, in contravention of the *Lottery Act*, the corporation considered the payments to be grants, made on behalf of the government to charitable and community organizations, and was treating them in its accounts as allocations of net income. Furthermore, we noted that none of the transactions had been recorded in the Lottery Fund special account or elsewhere in the government's accounts.

We concluded that the grant payments made by the Lottery Corporation lacked the normal review process typically applied by the responsible government ministry, and that details of the grant payments did not get publicly reported.

In response to our report, the Minister of Government Services announced on February 14, 1992, a moratorium on grant payments to community groups, pending a review of the CGL program. In that review, the government found that:

- grants were being transmitted directly from the Lottery Corporation to recipients;
- the program did not allow equal access;
- the size of each grant payment was not based on need, but on the volume of ticket sales made by the retailer; and
- the grant payments were being used for ongoing operational purposes, even though the organizations knew the program could be canceled at any time.

As a result of these findings, the government eliminated grant payments to community groups as of March 12, 1992. To offset this loss of revenue, however, it paid a one–time grant to each group that met a set of reporting criteria.

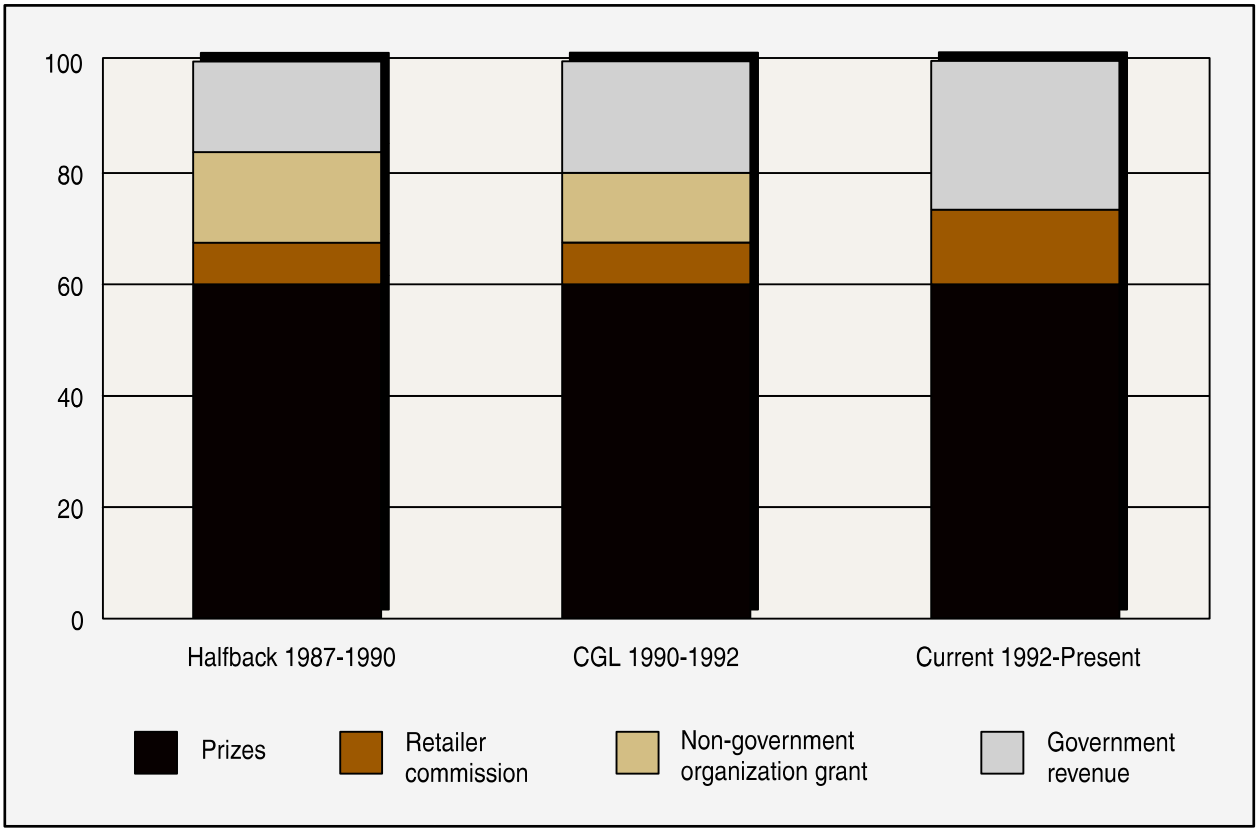
payment to be a commercial transaction and within the corporation's mandate. However, the corporation expressed concerns that these payments lacked commercial substance and were, in fact, grants.

In addition, the organizations had to demonstrate they qualified as a charitable organization. Eligibility criteria were those used by the government for licensing charitable gaming (including bingos, casinos, and ticket raffles) and were intended to "eliminate many of the questionable programs that had crept in under the previous loose criteria." Despite such intentions, a subsequent government review turned up anomalies (Exhibit 8.3) and the scheme was canceled on March 12, 1992. The government, in its review, referred to these payments as grants and, to offset the impending loss of revenue to the 817 community groups registered in the program, it made a one–time

Exhibit 8.3

Breakopen Revenue

Percentage distribution of breakopen revenue from 1987 to present



Source: British Columbia Lottery Corporation

grant available to each of them. In all, 585 applied for the grant. Total payments under the CGL program and the one–time grant from December 1990 to September 1992 were $10.7 million and $5 million, respectively.

Breakopen tickets are now sold in the same manner as are all other lottery tickets. This means that net proceeds, after prizes and retailer commissions are deducted, go directly to the government.

Exhibit 8.3 shows how revenue from the sale of breakopen lottery tickets has been distributed since 1987.

Detailed Findings and Conclusions

Who Was Eligible to Receive Public Funds?

The licensing process was the means by which the Lottery Corporation sought to ensure that only non–government organizations, approved by the corporation to participate in the CGL program, could receive grants from the proceeds of breakopen lottery ticket sales. To qualify for a license, the organization had to meet certain eligibility criteria. These were specified as follows in the application form:

1. The applicant must demonstrate that the primary objective or purpose of the group falls within one of the classifications of charity (as described below).
2. The applicant must be registered for at least 12 months preceding the date of application and be in good standing under the *Society Act* at the time of application; or, if not registered for that length of time, must demonstrate, with supportive documentation, a contribution to a significant portion of the community during the 12 months prior to the application.
3. The applicant must demonstrate there is a need for the funds to be raised.
4. Benefits derived from the funds raised must contribute to a significant portion of the community.
5. Except in special circumstances, funds raised shall be spent in the community in which they were raised.

These were established on the same basis as those criteria set by the British Columbia Gaming Commission for awarding charitable gaming licenses for such events as bingos, casinos, and ticket raffles.

Given the eligibility criteria, we expected the corporation to have set up a licensing process that would have:

- ensured that only organizations with a bona fide charitable purpose received licenses,
- assessed the need for the funds to be raised,
- ensured that the receipt of public funds would benefit a significant portion of the community, and
- ensured that the public funds were spent in the community in which they were raised.

How Was "Charitable Purpose" Demonstrated?

To qualify for a license, a non–government organization had to demonstrate that its primary objective or purpose fell within one of the following classifications of charity, as set forth in government policy:

- relief of poverty,
- advancement of education,
- advancement of religion, or
- for other purposes beneficial to the community where the benefits derived are available to a significant portion of the community. ("Other purposes beneficial to the community" is limited to amateur athletic sports, public safety, and public facilities).

In our review of a sample of applications, we found that some of the organizations did adequately demonstrate that their primary objective or purpose was charitable. For example, one society provided crisis intervention and counseling, emergency financial aid, and support to seniors and the handicapped in the community. Another society funded research, education, and facilities for cancer patients.

In some cases, however, we found it difficult to determine if the primary purpose of the organization was charitable. We noted, for instance, the following types of organizations that received licenses:

- a marina association,
- service clubs,
- a society for handcar races,
- a society for bathtub races.

In cases where the charitable nature of the organization was questionable, we at least expected to see written assessments from the corporation supporting the licensing decision. Instead, we found very few files that contained a written assessment. As a result, we were unable to determine how some of the organizations that received licenses had in fact satisfied the eligibility criteria.

How Was the "Need" for Funds Demonstrated?

According to eligibility guidelines, applicants had to demonstrate there was a need to raise the funds. "Need" was not defined, but we interpreted it to mean the organization required financial assistance to undertake the project.

The application form required the organization to describe the project, state the required funding, and explain how the project would benefit a significant portion of the community. There was, however, no requirement for the applicant to submit budgets or financial statements because the funds received by the organization were based on the volume of ticket sales by the retailers and not the financial need of the organization. As a result, we believe that many organizations received funds in excess of their needs.

We noted, for example, that one sports organization received a license even though its financial statements (which we obtained independently) showed close to $300,000 of surplus funds.

In summary, we concluded that the non–government organizations were not funded according to their financial needs.

How Was a "Significant Portion of the Community" Defined?

The corporation did not establish any guidelines to indicate what it considered to be a significant portion of the community. As a result we were unable to determine how several of the organizations met this criterion, and we don't think the corporation could make a similar determination. For example, we found:

- service clubs that were going to use the funds to purchase equipment for the benefit of their members only; and
- organizations that raised funds to support their own sports teams in a way that did not serve a significant portion of the community.

In conclusion, while we recognize the difficulty in defining a "significant portion of the community," it was clear to us that in many instances an appreciable number of community members had not benefited from the public funds provided to the licensed non–government organizations.

Were Public Funds "Spent in the Community"?

The eligibility criteria stipulated that all public funds were to be spent in the community in which they were raised, unless specifically exempted by the corporation. One organization stated on its application form that the funds raised would be sent to an orphanage in Uganda. It received a license, but we could not find any documentation in the file to support this exemption from the eligibility criterion.

In other cases, we found organizations that received a license specifically to raise funds for use in the community, yet went on to spend those monies outside the community and even outside the province.

How Were Public Funds Used?

With the significant amounts of public funding provided to non–government organizations through the CGL program, it was essential that the Corporation and the Community Grants Branch establish effective controls to monitor whether these funds were being used for their approved purposes.

The CGL agreement required the organizations at each anniversary date or on termination of the license to:

- submit a financial report, in a format approved by the corporation, detailing the revenues and disbursements of the CGL program;
- make available to the corporation all records pertaining to the CGL program; and
- limit selling expenses to a maximum of 20% of the public funds received.

When the CGL program was terminated on March 12, 1992, the government made available to the organizations a one–time grant equal to the last six months' proceeds. The grants were to be spent in British Columbia in a manner that would benefit each organization's communities. To be entitled to the grant, each organization was required to report to the corporation:

- the way in which it distributed (actual and planned) funds received between April 1, 1991, and February 14, 1992;
- the proposed use of the one–time grant; and
- the amount of selling expenses claimed.

Once the corporation reviewed the application form it was forwarded to the Community Grants Branch for final approval, distribution and monitoring of the one–time grants. Before receiving the grant, each organization signed an agreement requiring it to submit invoices, receipts, or canceled cheques in support of its reported expenditures, and allowing the government to audit the records if there was a question as to how the funds were used. Only 585 of the 817 licensed organizations applied for the one–time grant.

Based on the CGL agreement, we expected the corporation to ensure that:

- the distribution of funds was in line with approved purposes;
- appropriate documentation was received on a timely basis to support the reported use of proceeds;
- the funds were spent in a manner that would benefit their community; and
- selling expenses claimed were actually incurred.

As well, for the allotment of the one–time grant, we expected the Community Grants Branch to ensure that:

- the grant was spent as approved;
- the funds were spent in a manner that would benefit their community; and
- appropriate documentation was received on a timely basis to support the reported use of proceeds.

Were Public Funds Actually Spent for Approved Purposes?

Upon the cancellation of the CGL program, the corporation requested that licensees prepare a use of proceeds report for the period April 1, 1991, to February 14, 1992, as a requirement to receive the one–time grant. The corporation received reports from approximately 585 licensees and reviewed them to ensure that the listed use of public funds (actual and planned) was equal to the funds paid out. In most cases, they also ensured that the reported use of proceeds agreed to the approved purpose in the application form. If there were any discrepancies, the organization was requested to account for the shortfall. However, the corporation did not obtain appropriate documentation, such as invoices, receipts, or canceled cheques to support the reported use of proceeds.

In our review of the reports, we found that many of the organizations used public funds for approved purposes. However, there were a number of questionable uses of public funds which were listed on the reports received by the corporation which did not agree to the approved purposes shown on the application form. Some of these were:

- Several service organizations paid for property taxes on their buildings. The total of their payments amounted to approximately $339,000.
- Three law enforcement groups received funding for golf tournaments for their members.
- A sportsman's club paid $2,700 for a satellite dish to allow members to "view various sports activities not on current viewing channels."
- Many of the service clubs used a portion of the proceeds to pay for such items as repairs and maintenance, updating kitchen facilities and the purchase of new furnishings. One service club, for instance, spent over $30,000 on updating its building, and purchasing a shuffleboard game.
- A service club used the proceeds to offset a portion of its mortgage payment of $54,051.
- One service club used the proceeds to pay for audit fees of $11,662.

- One service club transferred over $19,000 to its general operating account.
- An education fund spent over $4,000 of the proceeds to offset a portion of the purchase price of a new car for its use.
- One organization sent funds to its parent organization in Ottawa. It did this without receiving corporation approval to spend the funds outside the province.
- A Chamber of Commerce used the funds to bring the Snowbirds precision flying team to perform at its civic festival in 1992 and 1994. The total cost was $13,500.

In another case, a service club reported making purchases of kitchen equipment totaling nearly $12,000. However, because it was unable to provide invoices or canceled cheques in support of the purchases, we were unable to determine where the funds were actually spent.

We also found that the corporation recommended that 53 of the non–government organizations should not receive the one–time grant because of missing information or for funds not being used for approved purposes. Still, most of these organizations did receive a grant from the Community Grants Branch. In many cases the missing information was received by the branch before the grant was paid, however, we did find examples where we could not determine why the branch had paid the grant:

- One society received $9,445 even though the corporation had found that the society was "manipulating funds contrary to the stated intention of the community group licensee application."
- One service club stated in its application that the funds were to be used to support various community groups. Instead, the club used $27,000 for its building and organizational expenses. The grant was used for the same purposes.
- Another service club stated in its application that the funds were to be used to provide assistance to seniors groups. Instead, $29,338 was spent on the club's building, as was the one–time grant of $13,075.

Were Selling Expenses Claimed but Not Incurred?

The CGL agreement specified that the licensee could claim a maximum of 20% of gross proceeds to cover the cost of selling expenses. We found, however, that:

- what constituted selling expenses was never outlined in any guidelines of the corporation to the licensees;
- the non–government organizations were not required to provide the corporation with documentation supporting the selling expenses; and
- the corporation made no attempt to ensure that the selling expenses claimed by the organizations were bona fide.

We estimate that over 65% of the licensees claimed selling expenses, in most cases the full 20% allowable. During our site visits, several of the organizations we visited were unable to provide us with documentation to support their claim for selling expenses. In fact, several organizations told us that they had not incurred any selling expenses and yet they claimed the full 20% allowable. As a result, because we were unable to determine if selling expenses were incurred, it is our opinion that some selling expenses claimed reduced the amount of public money available to benefit the community.

How Was the One–time Grant Used?

The one–time grant was the responsibility of the Community Grants Branch of the Ministry of Government Services. We were informed by the ministry that these payments were viewed as compensation, to ensure that no group was "unduly affected" as a result of the cancellation of the CGL program. Organizations already involved in the program were therefore eligible to receive up to six months' compensation. As well, we were told that the public funds paid as compensation had to "clearly benefit the community and not just the organization."

In order to provide the government with assurance that funds were used as approved, non–government organizations were required to submit documentation in support of their reported expenditures. Where documentation had been received, the branch ensured that the total amount of the grant was accounted for. If there were any discrepancies, the organization was requested to account for the shortfall.

We found, however, that more than one year after receiving the grant, many of the organizations had not submitted the required documentation.

Our review of the reports submitted turned up the following examples of how some of these funds may not have "clearly benefited" the community:

- A slo–pitch league paid $1,700 to stage a golf tournament for its members.
- A service club spent $4,000 on installing smoke extractors in its lounge.
- A service club used the entire grant of $39,045 to pay its property taxes.
- A social club used $3,500 to pay for a dinner for retired firefighters.

Were There Any Errors in Reporting Use of Public Money?

During our 20 site visits, we found a number of instances where the non–government organizations reported to two different government entities the same use of proceeds to support expenditures from two different programs. For example:

- A service club reported the same five cheques totaling $5,650 to both the Public Gaming Branch and the Lottery Corporation. We were unable to determine where the funds were actually spent and, before the audit team's departure from the premises, the club offered to reimburse the government for the $5,650.
- Another service club reported the same two cheques totalling $11,500 to both the Public Gaming Branch and the Lottery Corporation. It also reported the same seven cheques totaling $11,000 to both the Public Gaming Branch and the Community Grants Branch.

What Can We Conclude from Our Work?

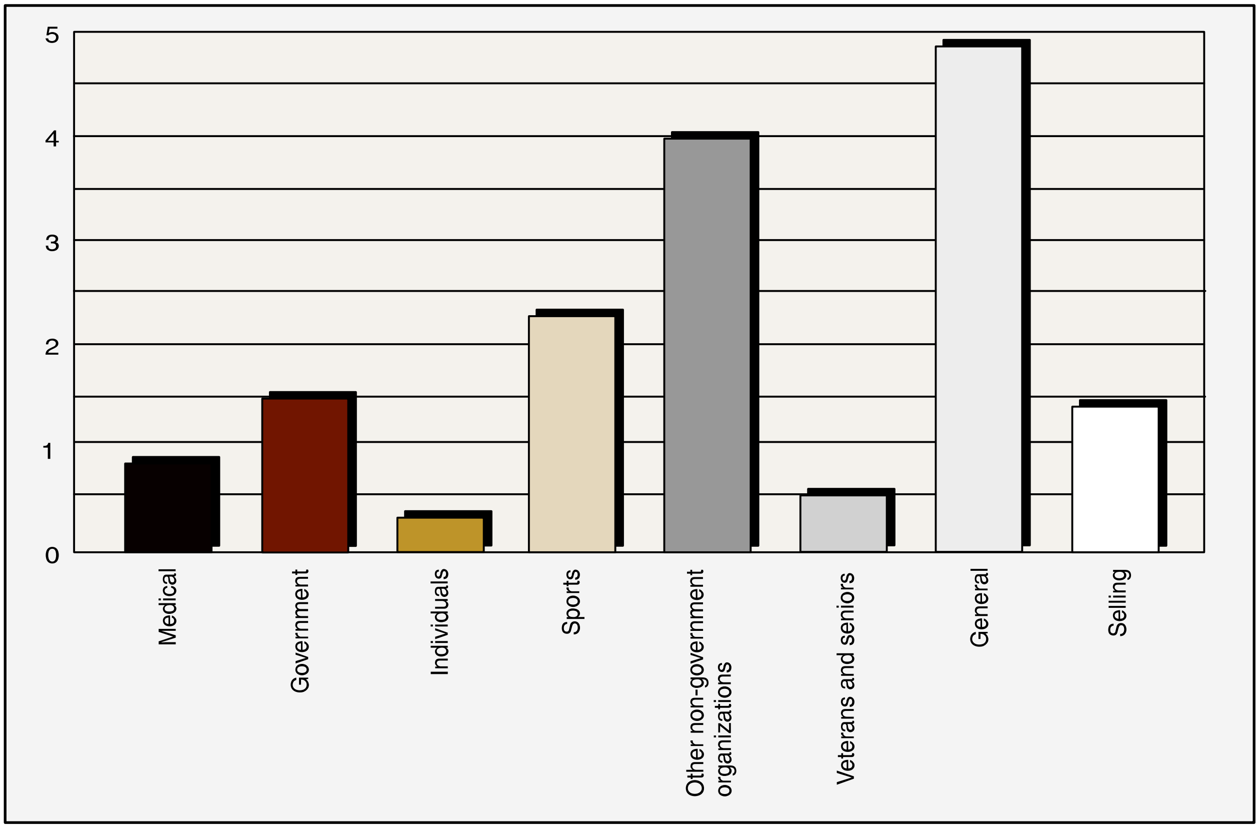
In conclusion, we found many of the organizations' expenditures to be questionable. Not only did the expenditures fail to meet the requirement of charitable purpose, they often appeared to be for the benefit of organization members rather than the community. In addition to this, not all funds were spent in the community or as reported.

Exhibit 8.4 shows our estimate of where public funds from the CGL program were spent.

Exhibit 8.4

Public Funding of Non–government Organizations

Where public funds from the CGL program went for the period, for the period December 1990 to September 1992 ($ Millions)



This graph was developed from our review of the one–time grant applications. The categories used were developed based on the type of expenditures reported. Examples for some of these categories are shown below.

"Medical" expenditures: equipment, supplies and research.

"Government" expenditures: municipal projects (civic centers, police facilities), parks and recreation, and schools.

"Individuals" expenditures: awards, scholarships, gifts, and food to individuals.

"Sports" expenditures: youth and adult teams, and provincial sports groups.

"Other non–government organizations" expenditures: youth services, civic festivals, fraternal and service organizations, religious groups, lobbying organizations, and aboriginal groups.

"Veterans and seniors" expenditures: war memorial funds, national office fees, and ceremonial expenses for color guards and senior citizen housing programs.

"General" expenditures: travel, building capital and maintenance, property taxes, and furnishings and equipment.

"Selling" expenditures: administration to the non–government organizations.

Response of the British Columbia Lottery Corporation

Public Funding of Non–government Organizations Through the Sale of Breakopen Lottery Tickets

Under direction from Government, the Community Group Licensee program was initiated by the BC Lottery Corporation in December, 1990. The objective was to allow charitable organizations the opportunity to earn wholesale commissions from the sale of breakopen tickets. This was not considered to be a grants program because it was recognized that the Corporation did not have a mandate to pay grants.

As pointed out in the Auditor General's report, the Community Group Licensee program did not contain the controls expected for a grants program because it was not a grants program. The payments were considered to be wholesale commissions and therefore the program was administered on that basis.

Now, when the program has wound up, the Auditor General's report suggests that the program was a grants program and poses that a set of standards relating to grants be applied. This, after the fact.

The Auditor General states that "although the organizations funded could fit under the broad guidelines as charitable, the charitable purposes for which the funding was requested was often not adequately assessed." The report points to the Royal Canadian Legions. The Corporation established breakopen commission criteria on the same basis as those that apply for bingos, casinos and ticket raffles. Royal Canadian Legion branches qualified for these licenses, hence they also were eligible to earn commissions from breakopen sales.

The Corporation agrees with the Auditor General's conclusion that the charitable organizations did not earn funding according to their needs but according to a commission payment directly related to sales of breakopen tickets. Accordingly, once the approved program's needs were met, the organization could reallocate funds to meet their own priorities.

The Auditor General stated that the Corporation did not obtain appropriate documentation, such as invoices, receipts or cancelled cheques, to support the reported use of proceeds. The Corporation agrees that these controls are appropriate for a grants program. However, this commission program only required organizations to submit a financial report detailing the revenues and disbursements of the breakopen sales commissions. The Corporation ensured that the charitable organizations complied with this requirement.

As noted by the Auditor General, a commission program requires different controls than those necessary for a grants program. More than once the Corporation expressed concerns to government and the Auditor General that the commission rate directed by government was too high and the earnings of many groups were getting out of line. After a review by the government, the program was terminated.

Response of the Ministry of Small Business, Tourism and Culture

Public Funding of Non–government Organizations Through the Sale of Breakopen Lottery Tickets

With the restructuring of government in the fall of 1993, the Community Grants Branch was relocated from the Ministry of Government Services to the Ministry of Small Business, Tourism and Culture. The Community Grants Branch administered the one–time compensation payout of the Community Group Licensee Program.

It was decided that the Community Group Licensee Program structure was flawed and that the program should be discontinued. Many groups had become dependent on this funding to meet operating expenses and there were sensitivities surrounding the announcement to eliminate the Community Group Licensee Program.

Given this environment, the Community Grants Branch reviewed the recommendations made by the Lottery Corporation, other supporting documentation and the intended use of the funds before making a recommendation as to eligibility for the payment of compensation.

Before the one–time grant was paid, each recipient organization was required to sign an agreement with the province stipulating that the funds would be spent as approved to benefit their community and that, when available, appropriate documentation supporting these expenditures would be submitted to the Community Grants Branch.

The Community Grants Branch monitored documents submitted by recipients in support of expenditures made with the grant funds to ensure that the funds were spent for approved purposes. This monitoring process continues.

Medical Services Plan: Claim Payment Systems

Medical Services Commission
Ministry of Health

A review of controls over the Medical Services Plan claim payment systems

Review Purpose and Scope

The Medical Services Plan (MSP) spent over $1.5 billion in the 1993/94 fiscal year, about one-quarter of the total health expenditure made by the province. For paying these expenditures, MSP (the term used in this report to also refer to the plan administration) processes a large volume of claims or bills for services provided across the province by many medical and other health care practitioners. This means that proper control systems are needed to receive, process, pay, and record those claims.

We conducted our review to assess whether internal controls established by MSP are adequate to provide reasonable assurance that payments issued by the claim payment systems are on behalf of registered "beneficiaries" (persons covered by the plan), for valid services and in the correct amounts; and that they are processed and recorded properly in the government's accounting systems. We reviewed the payment systems covering: fee–for–service medical and supplementary health care claims; salaried, sessional, and contractual claims; and interprovincial and out–of–country medical claims. We also looked at the processes for verifying services and reviewing patterns of practice or billing, designed to detect and deter improper billing to the plan. The beneficiary registration and premium billing system was outside the scope of our review. However, we looked at certain aspects of this system in order to explain who may receive services under the plan and how such services may be obtained. Issues noted as a result have been included in this report.

In 1989, we looked at whether MSP was able to ensure that it paid only for services that were medically required and valid. The focus of our current review was to examine automated and other control procedures designed by management for processing and paying claims and, therefore, did not include considerations of whether the payments were for medically required services. On the subject of validity of services, common in both reviews, we considered key issues identified in 1989 when performing our work for this review.

Over the past few years, the government has been working with the public and the medical profession to increase their participation in the setting of policy objectives for the plan, and in the management of funding available for the plan's program expenditures. We have included in this report our comments on key financial components of a recent agreement reached between the physicians (represented by the British Columbia Medical Association) and the government.

We obtained information about the claim payment systems by examining available documents, testing procedures, and interviewing Ministry of Health staff between March and September 1994.

Conclusions

Claim Payment Systems

Fee–for–Service Payment System

The fee–for–service payment system processes claims and issues payments for over 90% of the services billed by physicians and other health care practitioners. Under this system, a fee is paid for each eligible service provided to beneficiaries. Overall, we found that the fee-for-service payment system has reasonable control procedures to ensure that payments made are on behalf of registered beneficiaries and for services billed by registered practitioners, consistent with the approved schedule of services and fees. However, these procedures offer no assurance at the time when payments are made that the services billed were actually provided.

The procedures which ensure that beneficiaries receiving services are registered and have active coverage under the plan are generally satisfactory. Management, however, needs to assess the adequacy of eligibility documents it requires when registering new beneficiaries, and to complete its study for changes to the CareCard so that the risk of misuse of health care services is reduced. In this regard, we encourage MSP to continue to develop its review and investigation activities, and resolve the problem of multiple cards.

Recognizing the absence of direct evidence from the beneficiary of the receipt of service, management has put in place reasonable alternative review and audit processes to detect overpayments and deter improper billings to the plan. Some of these processes are recent or undergoing improvements. We believe that, when fully operational, these processes should provide management with better assurance about the validity of services and billings.

While management has adequate controls over data and computer systems to ensure the ongoing processing of claims, we believe that it needs to strengthen procedures for updating practitioner registration data, modifying computer programs, and dealing with prolonged interruptions to data processing.

Alternative Payment System

For certain physician services that are provided through hospitals and other health care agencies on a salary, sessional, or service agreement basis, we found that MSP has established reasonable procedures to ensure that billings are accurate and within the amounts approved for those agencies. However, we believe, MSP needs to obtain adequate patient and service data from agencies and improve its review and monitoring activities so that it may be confident that billings are for approved service programs, and for actual costs incurred by those agencies.

Interprovincial and Other Claim Payment Systems

Medical claims for services provided to residents of one province by a practitioner in another province or territory are billed and settled through provincial health plans based on a series of interprovincial agreements. To facilitate the administration of these claims, the parties rely on the control procedures in other provinces to ensure that claims submitted are for eligible services provided to registered beneficiaries, and that billed amounts are accurately calculated. While this arrangement appears reasonable, we believe that MSP should periodically find out how well those control procedures on which it is placing significant reliance are actually working.

Comments on the Agreement with Physicians

The recent agreement with physicians signed in December 1993 represents an important step by the government to involve the medical profession in the management of funding available for the plan’s program expenditures. The main focus of the agreement is to limit growth in medical expenditures over the fiscal years 1993 to 1997 through a number of expenditure reduction initiatives totaling $383 million.

We found that the agreement contains many complex and sensitive issues, with certain important provisions stated only in general terms. The nature and scope of these provisions and some expenditure reduction initiatives under the agreement are, in our view, described in such an unclear and wide ranging way that it is questionable whether the results intended can be conclusively measured.

An Overview of the Medical Services Plan

Introduction

The Medical Services Plan (MSP) pays for medically required and other eligible services provided by physicians and other health care practitioners (such as chiropractors and optometrists) to the residents of British Columbia. It also pays for laboratory services such as blood tests and X–rays. The plan operates under *the Medical and Health Care Services Act* and is administered by the Medical Services Commission of British Columbia. The Commission, restructured under the Act in 1992, consists of three representatives each from the British Columbia Medical Association, the provincial government, and the public. The operations of the plan include registering beneficiaries and licensed practitioners, billing and collecting premiums, checking and assessing claims, and making payments for services provided to beneficiaries. The management of medical services usage is also an important function of the Commission.

Generally, all British Columbia residents are eligible for MSP coverage. While the coverage is voluntary, some 3,452,000 (96%) of British Columbians are registered with the plan. An applicant has to meet certain eligibility and residency criteria to register, and thereafter pay monthly premiums or be eligible for premium assistance. Once the applicant is registered as a beneficiary, the costs of the medical and health care services he or she uses are covered by the plan. The physicians and other health care practitioners bill the plan for eligible services rendered and are directly paid by it.

Program Expenditures

Of the total health care costs of $6,320 million incurred by the province in the 1993/94 fiscal year, MSP expenditures were $1,593 million. Exhibit 9.1 shows that

A Brief Glossary of Terms

Fee–for–service medical payments are made to physicians (including specialists and surgeons) and laboratories for services rendered to beneficiaries under the plan. The payments are calculated according to an approved schedule of fees.

Alternative payments are made to hospitals, cancer clinics, and community health care centers or agencies employing physicians on a salary, sessional, or service agreement basis. This method of payment is normally used to fund medical and clinical services such as hospital emergency and intensive care, radiology services, and psychiatric services.

Out–of–province payments are made for medical services obtained by beneficiaries during their temporary stay or visit in another province or outside Canada.

Medical practitioner benefits include contributions to physicians' education, disability insurance, practice liability insurance, and retirement saving programs.

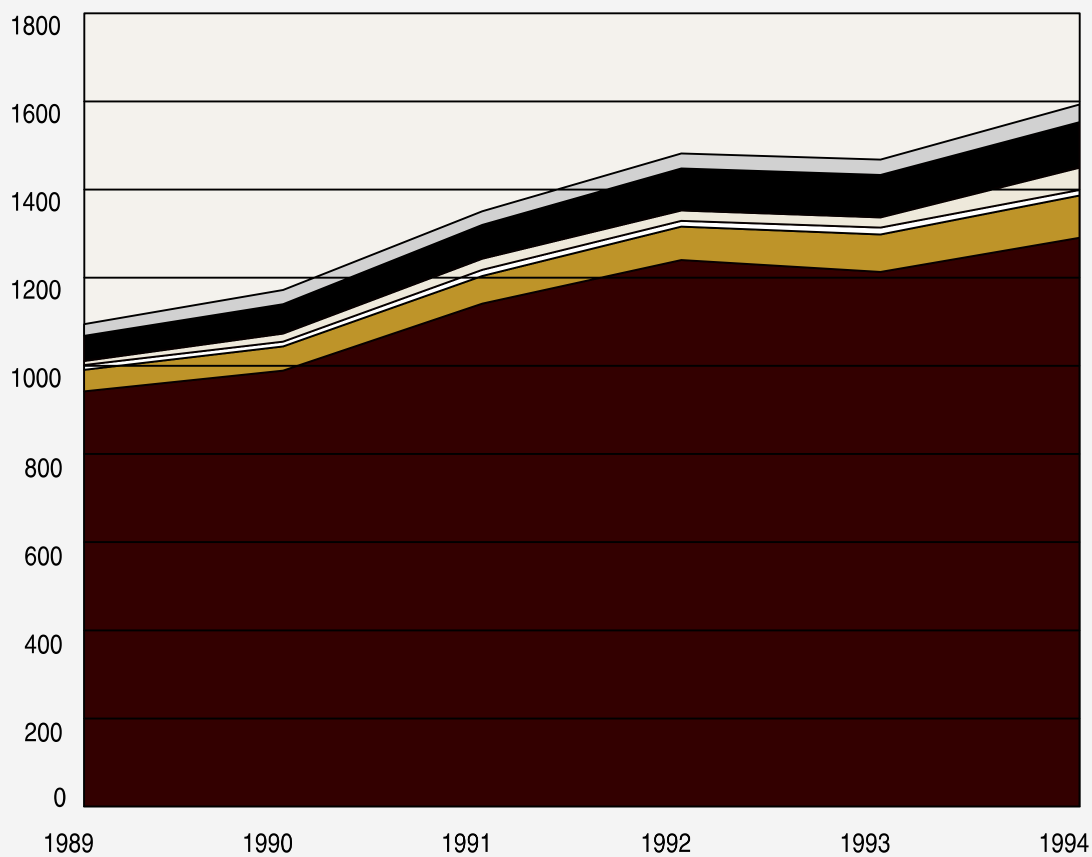
Supplementary health care payments are made for services provided by chiropractors, optometrists, physiotherapists, and other such health care providers. The payments, made on a fee–for–service basis, are calculated according to an approved fee schedule.

Administration expenditures are those made for staff salaries, data processing costs, and general office costs.

Exhibit 9.1

Medical Services Plan Expenditures, 1989 to 1994

Increase in expenditures by main categories ($ Millions)



		1989 ($)	1994 ($)	Increase from 1989 to 1994 ($)	Increase from 1989 to 1994 (%)
Medical:	Fee-for-service	942	1,290	348	37
	Alternative payments	49	96	47	96
	Out-of-province	11	13	2	18
	Practitioner benefits	9	51	42	467
Supplementary health care		57	103	46	81
Administration		27	40	13	48
		1,095	1,593	498	45

Source: Medical Services Plan Financial Statements and Accounting Records these expenditures increased from $1,095 million in 1989 to $1,593 million in 1994, an increase of $498 million (45%) over the past five years. The exhibit also provides a summary of increases over the period in each of the main expenditure categories. Exhibit 9.2 presents key statistical information and a brief analysis of some of the main factors affecting the plan expenditures.

Funding the Plan Expenditures

The plan expenditures are funded by beneficiary premiums and government contributions. The current levels of monthly premiums range from $36 for one person to $72 for a family of three or more. The premiums have generally provided about half the funding required to meet plan expenditures and, in 1993/94, it amounted to $779 million. The government contributed $814 million to meet the remaining 1993/94 expenditures: $226 million as premium assistance to beneficiaries with low income or on income assistance, and $588 million in general contribution.

Exhibit 9.2

Key Statistical Information for the Medical Services Plan, 1989 to 1994

A brief analysis of factors affecting MSP expenditures

Summary Analysis

From 1989 to 1994, Medical Services Plan expenditures increased by $498 million (or 45%). Of this increase, 17% can be attributed to the growth in number of beneficiaries and 8% to higher service usage. A substantial portion of the remaining 20% of the increase in expenditures, or $220 million, can be attributed to higher fee payments and benefits. By comparison, the Consumer Price Index during the same period increased by 23%.

Average Service Usage and MSP Cost Per Person

- For 1993/94, estimates of average service usage and MSP cost per person by age category are as follows:

Age category	Number of beneficiaries	Number of services per person	Average MSP cost per person ($)
Under 40 years of age	1,979,000	11	350
Between 40 and 59 years of age	866,000	16	450
Between 60 and 79 years of age	503,000	27	810
Over 80 years of age	104,000	35	970

Number of Beneficiaries

- The number of beneficiaries increased by 502,000 (or 17%) from 1989 to 1994. The increase, as can be seen from the table below, varied across age groups:

	Increase in beneficiaries	
Age category	Number	%
Under 40 years of age	238,000	14
Between 40 and 59 years of age	184,000	27
Between 60 and 79 years of age	56,000	13
Over 80 years of age	24,000	29

- The trend in aging of the beneficiary population is forecast to accelerate over the next three decades. This means that the plan is likely to experience greater cost pressures, given the relatively higher medical demands of the aging population.

Service Usage

- The average service usage per beneficiary increased from 14.2 times to 15.6 times (about 10%) from 1989 to 1994. This is likely to have caused an increase in MSP expenditures of about 8%, when account is taken of a change in the mix of medical and supplementary health care services over the five years.
- In 1993/94, the plan paid for over 53 million services provided by British Columbia physicians and other practitioners to beneficiaries of the plan: 87% of the services were for medical care and 13% for supplementary health care. The increase in these services over the past five years was as follows:

	Increase in service usage	
	Number	%
Medical care services	8.5 million	23
Supplementary health care services	2.6 million	60

Fees and Benefits

- From 1989 to 1994, the medical fees increased on average by about 14% and supplementary health care fees by 10 – 16%, excluding lump–sum payments.

  Examples of current fees paid for some common services include: $24.30 for a general examination; $54.05 for a consultation or complete physical examination; $15.11 for a haematology test; $11.12 for each unit of anaesthesia of between 10 and 15 minutes; and $16.45 for a chiropractic treatment.
- The benefits payable to physicians increased from $9 million in 1989 to $51 million in 1994. The biggest increase was in 1994, when the government started a new annual benefit of $25 million paid into a fund for contributing to retirement saving plans of individual physicians.

Number of Practitioners

- There were 725 more general practitioners, 233 more specialists and surgeons, and 876 more supplementary health care practitioners providing services under the plan in 1994 than in 1989. This represents an increase of 22%, 8%, and 50% respectively. For the year ended March 1994, there were:

4,080 general practitioners	or 1 per 840 beneficiaries
3,060 specialists and surgeons	or 1 per 1,130 beneficiaries
2,640 supplementary health care practitioners	or 1 per 1,310 beneficiaries

Source: Developed from data provided by the Ministry of Health

This section is continued in Section 8a (Financial Highlights).

Click here to proceed to Section 8a.

The MSP Environment and Payment Systems

The MSP Environment

The control objectives of the MSP claim processing systems are to provide reasonable assurance that payments made are for services rendered to beneficiaries and billed by registered practitioners, consistent with the approved schedule of services and fees. To understand the design of the procedures established to achieve these objectives, it is important to take into account the nature of the plan operations. The way policies and procedures are designed for any program is strongly influenced by the unique features of that program.

The plan pays for services rendered to a third party—the beneficiary—by another third party—the practitioner—but it neither arranges nor initiates the service. Also, it is not reasonable to expect patients or beneficiaries to notify MSP of the receipt of service before payment is made because of the large volume of services (over 53 million in the 1993/94 fiscal year). This has a significant bearing on how MSP may carry out its control activities.

Further, in managing the program and, more particularly, in attempting to verify the validity of service, MSP needs to respect the confidentiality of patients' medical information and the professional judgement of practitioners. Similarly, when investigating suspected improper use of the plan services by beneficiaries, MSP has to consider what information it can lawfully collect from third parties.

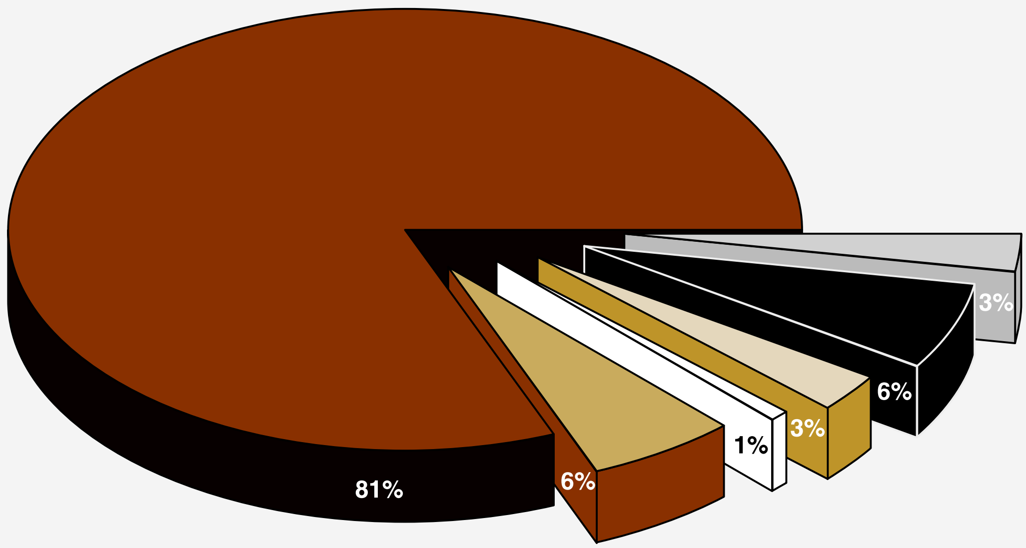
Considerable importance is therefore attached to the presumption of trust and honesty on the part of both the beneficiary and the practitioner. Applicants and beneficiaries are expected to make honest and accurate representations when they apply to register for coverage or request health care services, and to notify MSP promptly when their circumstances change. Practitioners are expected to bill only for services that have been rendered, and only for the correct type of service. Under these circumstances, there is a risk that some beneficiaries and practitioners will act in a manner that undermines the trust placed upon them. It is thus the responsibility of management to determine the size and extent of this risk so that it can design appropriate internal control procedures. In designing these procedures, management is faced with the challenge of ensuring that the resulting control systems are not so cumbersome and costly as to adversely affect the orderly and efficient conduct of the plan operations.

The whole task of designing and maintaining these control systems is made more difficult by the need to handle large volumes of claim transactions efficiently and to pay practitioners on a timely basis. The latter explains, in part, why many internal controls in the MSP payment systems tend to be of a post–facto nature, that is, focused on identifying errors in the amounts already paid.

Exhibit 9.3

Medical Services Plan Expenditures for the Year Ended March 31, 1994

Expenditures by main categories ($ Millions)



		1994
		$
Medical:	Fee-for-Service	1,290
	Alternative Payments	96
	Out-of-Province	13
	Practitioner Benefits	51
Supplementary Health Care		103
Administration		40
		1,593

Source: Medical Services Plan Accounting Records

Claim Payment Systems

To process service claims relating to various expenditures shown in Exhibit 9.3, MSP has developed the following systems:

- the fee–for–service payment system for in–province medical and supplementary health care service claims paid on the basis of a fee for each service rendered;
- the alternative payments system for in–province medical service claims paid a salary, sessional, or service agreement basis;
- the interprovincial payment system for claims relating to medical services provided to

British Columbians by other provincial health plans; and

- other systems for the direct reimbursement or payment of medical costs to beneficiaries and practitioners, including those costs for out–of–country medical claims.

The medical practitioner benefits and administration expenses are paid through the general expenditure systems of the government. We did not examine controls over these expenditures, as our review was focused on claims for practitioner services provided.

This section is continued in Section 12a (Medical Services Plan: Fee–for–Service Payment System).

Click here to proceed to Section 12a.

Medical Services Plan: Claim Payment Systems

Medical Services Commission
Ministry of Health

Section contents

This section is continued from Section 12.
(Medical Services Plan: Claim Payments System)

Fee–for–Service Payment System

Background

The Medical Services Plan uses the fee–for–service system to pay for over 90% of the services billed by physicians and supplementary health care practitioners ("the practitioners"). Under this system, MSP pays a fee for each eligible service rendered to beneficiaries. For the year ended March 1994, MSP paid $1,393 million for over 53 million services provided to 3.4 million beneficiaries on a fee–for–service basis.

The plan receives claims for payment of services from over 3,600 locations around the province and processes them centrally in Victoria. Most practitioners submit claims using the Teleplan system (a computer network for transferring claims data) or magnetic tape. A small number of claims continue to be received on manual cards. All claims are validated electronically against beneficiary, practitioner, and approved service and fee data. The claims are also checked for unusual and duplicate services. The accepted claims are then paid semi–monthly and recorded in the government's accounting systems.

The processing and payment component of the fee–for–service payment system is supplemented by a number of control procedures for verifying services and reviewing patterns of practice or billing. These procedures, designed to detect and deter improper billing, are carried out mostly after the claims have been paid.

For ensuring that payments are made only on behalf of registered beneficiaries, the fee–for–service payment system relies on another system, the registration and premium billing system, which maintains beneficiary registration records. While this other system was outside the scope of our review, we looked at the basic registration requirements and the use of the British Columbia CareCard to explain who can receive services under the plan and how these services can be obtained. Any matter which came to our attention as a result has been included in this report.

Conclusion

We believe that MSP has adequate procedures for ensuring that payments are made only on behalf of registered beneficiaries. The practitioners check patients' identity and eligibility to receive services by referring to the CareCard and, before claims are paid, MSP validates that the patient was registered and had active coverage at the time of service. Nonetheless, medical and health care services are vulnerable to some abuse, particularly by persons who do not meet the citizenship or Canadian residency criteria, MSP beneficiaries who reside outside the country, and multiple cardholders. To prevent and detect such abuse and to resolve the problem of multiple cards, MSP is working to make changes to its CareCard design and improve its investigation activities. In our work to explain who may be covered under the plan, we noted a need for assessing the adequacy of evidence sought before applicants are registered.

For ensuring the validity of services, MSP has developed adequate procedures to check that services billed by practitioners are consistent with the approved rules and conditions. However, the fee–for–service payment procedures are not designed to show evidence, when payments are made, that the services billed were actually provided. We found reasonable alternative review and audit processes to detect and, more importantly, deter improper billing to the plan. Some of these processes are recent or undergoing refinements. When fully operational, the review and audit processes should provide management with complete information to better assess the extent of improper billing and develop any required action.

After the claims have been validated for beneficiary registration and validity of services, effective controls are applied to them to ensure that payments are accurately calculated and properly authorized.

The ongoing and effective operation of the above procedures depends on the integrity of data and programs and proper functioning of the computer systems. In our opinion, management has reasonable controls over data and computer systems. We identified specific improvements to procedures for updating practitioner registration data and general systems documentation, changing computer programs, and dealing with lengthy interruptions to data processing.

Findings

Ensuring Payments Made Are on Behalf of Registered Beneficiaries

When making payments to practitioners, the fee–for–service system ensures that they are made on behalf of beneficiaries who are registered and have current MSP coverage.

Beneficiary Registration

To be eligible for MSP coverage, a person must be a Canadian citizen or lawful resident of Canada, must make his or her home in British Columbia, and must be physically present in the province for at least six months in a calendar year. To obtain coverage, the person must register with the plan and pay premiums or qualify for premium assistance.

As part of its registration process, MSP requires new applicants to submit documents such as a birth certificate, citizenship card, passport, landed immigration record, and other such evidence to support their identity and legal status in Canada. For attesting to their British Columbia residency, however, no documentation is required. Instead, the applicants sign a declaration of residency on the application form.

Because MSP does not require the documents to be in original form and performs little checking to ensure that the information contained in the documents and on the application is valid, we are concerned about whether the documents required for registration and related checking procedures provide the necessary assurance to management that only eligible applicants are registered. Furthermore, since the requirement for supporting Canadian citizenship did not come into effect until July 1993, we are also concerned that ineligible persons may already be registered on the system.

Persons who were eligible for MSP coverage when they first applied may become ineligible over time because of loss of their British Columbia residency. This means that people who no longer reside in the province for the required six months in a calendar year, or who may have moved permanently outside the province, are not eligible to continue receiving MSP services.

Management acknowledges that most beneficiaries who leave the province for more than six months neglect to inform MSP. Thus, it has to rely on the voluntary reporting of changes by beneficiaries so that coverage for such persons can be cancelled. In most cases, however, this may not be a major concern, since a person leaving the province for an extended period of time would stop paying the premiums and his or her MSP coverage would automatically become inactive after 90 days. The risk lies mainly with beneficiaries who deliberately neglect to inform MSP of a change in their resident status because they find it beneficial to continue to pay the premiums and maintain coverage. Considering that most persons who live in Canada have access to a largely universal, portable and publicly funded health service, the risk lies more with persons who have moved to reside outside the country for extended periods of time, or permanently.

Management is aware of the importance of maintaining the integrity of its registration records and detecting abuse of the system by

Exhibit 9.4

The British Columbia CareCard

The British Columbia CareCard shows beneficiary's ***name, birthdate,*** and unique lifetime ***personal health number.***

Some cards also show ***unit code*** (for access to other program benefits such as Pharmacare) and ***expiry date.*** Seniors are issued gold CareCards.

The CareCard is made of plastic, with a space for signature and a magnetic stripe on the back. The magnetic stripe contains information shown on the face of the card.

Source: Ministry of Health

ineligible persons. In the eligibility and residency checks it carries out on beneficiaries and users of the plan, MSP continues to find instances of ineligible persons registered under the plan and using its benefits. However, the work carried out by MSP investigators has tended to be reactive, primarily following up on tips from concerned citizens and other outside sources. The work has also not been formally coordinated with other audit activities in the organization. Management has recognized the shortcomings of its investigation work and is currently undertaking a number of steps to improve the effectiveness of its investigation activities.

We recommend that MSP take appropriate steps, including improvements to its current documentation requirements for registering new applicants, so that only British Columbia residents who are Canadian citizens or lawful residents of Canada may be registered as beneficiaries under the plan. We encourage management to continue to develop its review and investigation activities which detect abuse of the system and ensure registration of only eligible persons.

The British Columbia CareCard

Upon registration, a beneficiary is issued a British Columbia CareCard, an example of which is shown in Exhibit 9.4. The CareCard is used by the holder to obtain not only medical and supplementary health care services but, in many cases, also Pharmacare and fee–waiver benefits. This makes the card valuable and, hence, susceptible to misuse. It is important that the CareCard and beneficiary identification procedures be designed to prevent, as far as possible, abuse of the MSP system.

The plan looks to practitioners to confirm, at least on all first appointments, the patients' identity and their eligibility to receive services. It has reasonable assurance that the practitioner will be diligent in this check because payment to practitioners is withheld if they provide services on invalid cards or cards with inactive coverage. To help practitioners verify details shown on the CareCard at the point of service, MSP has provided them with computer and telephone access to certain registration information. This procedure is adequate in most cases: it confirms that the CareCard is valid and that it belongs to a person who has active coverage. Still, it does not provide conclusive evidence of a patient's identity and eligibility. The patient could be improperly using a replaced card or a borrowed card.

The plan issues about 16,000 CareCards a month to replace lost, stolen, or damaged cards and to update or correct personal information or the unit code for other benefits shown on the card. When a replacement card is issued, few third–party documents are required and, because of practical problems, MSP does not require beneficiaries to return the old card. It is therefore inevitable that there would be more cards in circulation than there are registered beneficiaries. In our review, we noted that there were about 46,000 persons who were issued four or more cards over the last year. Because the design of the current CareCard is such that newly issued card cannot be distinguished from the one being replaced, potential exists for replaced cards to be misused. We are concerned about whether the current design of the CareCard and the standard of evidence required to support requests for replacement cards are appropriate to minimize card misuse.

Management fully recognizes the problems with CareCards and has recently instituted a fee of $10 per card to reduce the number of requests for replacement. It is too early to assess the impact of the new policy. As well, in conjunction with the recent reorganization of its investigation function, management has undertaken a number of initiatives: first, to examine the problem of multiple cards; and, second, to study ways in which the CareCard can be improved so that it provides better evidence of the cardholder's identity and eligibility for MSP coverage.

We recommend that MSP review its current requirements for the issuance of replacement cards to assess whether they provide sufficient supporting evidence before a new CareCard is issued. In the meantime, we encourage MSP to complete its study of alternative ways in which it can enhance information about the beneficiary's identity and eligibility on the CareCard.

Automated Eligibility Checks

To ensure that claims submitted by the practitioner relate only to registered beneficiaries with active coverage, the fee–for–service payment system performs a number of validation ("edit and eligibility") checks.

The checks are carried out by reference to the beneficiary registration file, which contains data on the beneficiary and on his or her coverage status. They ensure that the beneficiary's name, personal health number, and other pertinent information on a claim is valid. The system also checks that the beneficiary had active coverage at the time of service—that is, the premiums were paid up.

We verified these procedures using test data and found them to be satisfactory.

Ensuring Services Are Valid

Services are considered valid when they are billed in accordance with specific rules and conditions set by the Medical Services Commission, and when they have been rendered by a registered practitioner. For obtaining assurance about the provision of services, MSP confirms services billed by selected practitioners with patients, carries out reviews of practitioner's patterns of practice or billing, and performs audits of practitioners and laboratories.

Edit, Eligibility, and Adjudication Procedures

The practitioners use service identification codes, commonly referred to as fee codes, to describe services provided. The Commission has currently approved over 3,200 service identification codes, representing all services that practitioners can bill MSP. The codes with corresponding fee amounts are part of the payment schedule, which acts as a reference table for validating claims when they are processed by the fee–for–service payment system. Included in the system are numerous rules that specify conditions and circumstances when particular services may be claimed.

To ensure that services billed are appropriate for payment, MSP performs a number of edit, eligibility, and adjudication checks on claims submitted by practitioners. The edit and eligibility checks are performed to ensure, among other things, that the service identification code charged on claims is an approved code. The adjudication checks, on the other hand, are designed to ensure as far as possible that the service billed is reasonable and appropriate for payment, consistent with the pertinent rules and conditions. The service charged has to be within the registered specialty of the practitioner and has to be reasonable in the context of the patient's gender, age, and medical history. The fee–for–service payment system also contains other specific rules such as: the number of times that a service can be claimed within a certain time period; the services that can or cannot be claimed when another service is also billed; and the types of service that can be billed from a hospital or practitioner's office. As well, a check is made for duplicate claims.

Most of the checking performed on claims received by the plan is automated. This helps MSP to process large volumes of data on a timely basis and to ensure consistent application of complex billing rules. The automated checking is able to handle most of the claims without the need for manual intervention. Claims that are not accepted by the system are then reviewed manually by adjudicators. Management recognizes that adjudication work often involves interpreting complex rules and a patient's medical history. For this, it relies on the training and experience of adjudicators and on the regular supervisory review of their work.

We tested key edit, eligibility, and adjudication procedures, using a number of common services billed by practitioners. We found that generally the key procedures were working satisfactorily.

Confirming Services Billed with Patients

The confirmation process attempts to detect instances of improper billing, mainly those arising from services not actually rendered. Each month, MSP selects about 100 practitioners and sends some 5,000 letters to their patients, asking them to confirm whether the services shown were actually rendered. The concerns we had raised in our 1989 report about the need for improving clarity of confirmation letters and updating beneficiary addresses have largely been dealt with.

Not all services are included in the confirmation process. Laboratory and diagnostic services are covered under a separate auditing program and not confirmed with patients. Other services, such as anaesthetic or psychiatric, are not confirmed because of their nature. Management believes, however, that the remaining services provide an acceptable level of coverage.

Normally, two–thirds of the patients respond to confirmation letters. Of this, about 97% typically agree that the services were actually received. When a patient disputes the service, staff generally make certain enquiries and follow established procedures to resolve the discrepancies. This helps them determine “errors” or probable cases of undelivered or improperly billed services.

Staff tabulate results for each practitioner in the sample and have determined an absolute number of errors that they are prepared to accept. However, we found that there are no standard procedures to relate errors to the total services in the sample or in the responses that were actually received for that practitioner. Neither has management set any defined or minimum level of response for each practitioner so that the results can be compared and more meaningfully evaluated. Consequently, for example, a practitioner with 3 errors out of 30 actual service responses (a 10% error rate) might be considered to have an unusual billing pattern while a practitioner with 2 errors out of 10 responses (a 20% error rate) might not. And, as we noted in 1989, there continues to be a need for follow–up and investigation of unusual cases identified through the confirmation process.

We recommend that MSP set standards and procedures to properly and consistently measure the results of confirmations so that for errors noted it can determine if further action is warranted. Procedures should also be established for ensuring appropriate and complete follow–up of the results of the confirmation process.

Reviewing Patterns of Practice

Reviewing a practitioner’s patterns of practice is an important activity that helps MSP detect and deter significant improper billing to the plan. Under this process, a practitioner’s patterns of practice or billing is compared with the average for the specialty in terms of, among other things, the number of patients served, the number of services performed, the cost per patient, and the billing frequency and amounts.

Significantly aberrant practices or profiles are followed up and, if necessary, investigated.

To identify aberrant profiles, MSP uses its fee–for–service payment data. Profiles of supplementary health care practitioners are prepared for review by the appropriate professional associations. The physician profiles are reviewed by the Patterns of Practice Committee, with representation from the Medical Services Commission, the British Columbia Medical Association (BCMA), the College of Physicians and Surgeons of British Columbia, and the public. In response to our 1989 report, MSP had indicated that it would work with the BCMA to communicate more effectively the purpose and results of this activity. This, we believe, has now been addressed through the physician's newsletter, a recent fee agreement reached between the government and physicians in 1993, and the public reporting by the college of instances of excessive billing.

Of the approximately 7,140 medical practitioners who bill the plan, the process identifies 200 to 300 cases a year that require further scrutiny. Most of these are found to have acceptable reasons for the high level of billing or servicing. About 20 to 30 cases actually result in an interview with the practitioner or an in–depth investigation of the practitioner's patterns of practice or billing. Over the past two years, 11 practitioners have been ordered to repay the Medical Services Commission approximately $3.3 million. The review process is extremely time consuming and an in-depth investigation can take three or more years. The issues are complex and subjective, and the parties must receive full opportunity to make their case. As a result of the investigations under way, in–depth reviews of new cases are delayed.

Management recognizes that reviews of the practitioners' patterns of practice are aimed mainly at finding out significantly unusual cases. To provide more complete coverage against instances of improper billing, it looks to other audit and verification procedures. Two of these procedures are discussed below under the sections, "Practitioner Audits" and "Laboratory Audits."

Practitioner Audits

On–site auditing of practitioners is an additional, useful tool that MSP has begun to use to guard against incorrect billings. This activity has been better defined and strengthened with the passage of the *Medical and Health Care Services Act* in 1992. An Audit and Inspection Committee has been created and delegated powers by the Medical Services Commission for determining and guiding audits of physicians. To carry out these audits, a new audit section has been formed. The section is also assigned responsibility for audits of supplementary health care practitioners. We found that adequate policies and procedures have been prepared to assist staff in conducting the audits.

To date, that section has carried out a small number of practitioner audits to follow up on unusual billings or practices. As this program develops and sufficient audits are performed, we believe that this new initiative will considerably strengthen MSP's processes for detecting and deterring improper billings.

Laboratory Audits

In 1993/94, over 18 million laboratory and diagnostic procedures were performed at a total cost to MSP of $340 million. As noted earlier, such services are not confirmed with patients because they are covered under the auditing program for laboratories. This program involves on–site audits of billings by laboratories or diagnostic facilities. The audits help identify instances of excessive servicing, undelivered services, and non–compliance with protocols for diagnostic practices and billing.

Until recently, these audits were contracted to outside consultants. Over the past year, however, this responsibility has been assigned to the new audit section noted above. Based on the results of these past audits and their further study by the Medical Services Commission, the section has estimated potential recoveries of about $7.4 million. Since assuming responsibility for laboratory audits, the new audit section has carried out about a dozen audits. The laboratory audits, we were advised, have resulted in removing many of the ambiguities that were responsible for problems with laboratory billings and in improving the adjudication checks done by the fee–for–service payment system. Management at MSP will be able to fully assess the effectiveness of these improvements as more audits are carried out by the newly formed audit section.

Ensuring Payments are Correctly Made and Properly Recorded

The fee–for–service claims submitted by practitioners to the plan include, among other things, the service identification code and the fee amount. When the fee–for–service payment system checks to see that the service identification code charged on claims is an approved code, it simultaneously compares the fee amount on the claim with that in the payment schedule. The service identification code, and therefore the fee that a practitioner can normally bill, is restricted by his or her specialty registered with MSP. As noted earlier, the payment schedule includes over 3,200 service identification codes and fee amounts.

We tested the edit and eligibility rules in the fee–for–service payment system and determined that procedures to ensure that claims are calculated at the correct fee rates were satisfactory. There are appropriate procedures to reconcile total claims accepted for payment by the system, to approve these claims, and to record them in the government's accounting system. The system also ensures that payments, which are largely made by electronic fund transfer, are made to the right payee.

Controls Over Data and Computer System

The fee–for–service computer system processes large volumes of claims received from many practitioners. To ensure that these claims are processed accurately and on a timely basis, it is important that there be proper controls over data and computer system.

The fee–for–service payment data are processed and maintained at the British Columbia Systems Corporation (BC Systems) Computer Centre in Victoria. We reviewed a third–party report provided to us by BC Systems, which concluded that the practices and procedures at BC Systems were sufficient to provide reasonable assurance that controls over computer activities were adequate. The report, however, identified a weakness in the area of change controls for programs designed to operate computer systems. It also identified a number of user responsibilities, such as establishing controls over access to data and programs and developing proper disaster recovery procedures. The latter issues are discussed later in this report.

Controls Over Data

Controls over data are necessary to ensure the integrity of incoming claims and of data files resident in the computer system. The data files are used as reference files for validating the practitioner, the beneficiary, the type of service, and the fee amount shown on claims. To accurately process claims, MSP depends on approved and current data files, mainly the practitioner information file, the beneficiary registration file, and the payment schedule.

Incoming Claims Data

As 98% of the claims are submitted electronically through the Teleplan system, MSP has to ensure that they are transmitted only from authorized locations or by authorized practitioners. A practitioner has to be registered with the plan before he or she can apply for electronic billing. Through the issue of the Teleplan number (a registered data center number), as noted below, and the requirement for use of a password, we believe that MSP has established adequate security procedures over the incoming claims. These claims are also checked for correct format and completeness of data before they are processed further.

Practitioner Information File

The practitioner information file is a registry of practitioners, showing a profile of individual practitioners registered with the plan. It includes information such as the practitioner billing number, the payee number, the type of practice, the work and licence status—that is, whether in practice, suspended, retired, or deceased—and the Teleplan number for transmitting claims.

Before a practitioner can bill the plan, he or she must make an application to register with the plan. Procedures are in place to confirm that the applicant is licensed by his or her professional association to practice in British Columbia. Once the application is approved, the practitioner is issued a billing number. Only one billing number is normally issued, unless the practitioner belongs to two different professional bodies. The practitioner is also provided with a communication line and the Teleplan number. This links the practitioner’s office with the MSP computer system for the exchange of claims data.

Changes to data in the practitioner information file are made mainly from monthly reports received from the practitioners' professional associations and from information reported by practitioners. We performed a review of the MSP's practitioner information file for all practitioners and, for medical practitioners, also compared the file with data maintained by the College of Physicians and Surgeons of British Columbia. We found some instances of practitioners issued with two billing numbers although they belonged to only one professional association. We also noted a number of discrepancies in the data regarding the type of practice and the work and licence status of practitioners, as shown in the records maintained by MSP and the college. While our tests did not uncover improper billings, these discrepancies indicate weaknesses in the procedures for updating the practitioner information file.

We recommend that MSP improve its procedures for updating the practitioner information file so that it can properly validate incoming claims data. Consideration should also be given to establishing procedures for periodically comparing the practitioner information file with the relevant practitioner data maintained by the professional associations.

Beneficiary Registration File

The beneficiary registration file contains data on all registered beneficiaries, including information on whether the beneficiary has active coverage. To maintain active coverage, premiums must be paid up. The fee–for–service payment system relies on another system, the registration and premium billing system, for the accuracy of the beneficiary registration file. While this other system was outside the scope of our review, we have included pertinent issues surrounding beneficiary registration under the section, "Ensuring Payments Made Are on Behalf of Registered Beneficiaries."

Payment Schedule: Service and Fee Data File

As noted earlier, the payment schedule on the fee–for–service computer system includes about 3,200 service identification codes with corresponding fee amounts. Before any changes are made to service identification codes or fee amounts contained in the payment schedule, they must be approved by the Medical Services Commission. We found there are appropriate supervisory procedures in place to ensure that only authorized changes are processed on the system. Once the changes are made, the updated data are reviewed to check that the changes were made accurately.

Controls Over Computer System

Computer processes for validating the practitioner, beneficiary, service, and fee amounts shown on claims depend on the proper functioning of computer programs. In turn, these programs rely on the proper functioning of security and other general control procedures.

Electronic Access Security

Electronic access security refers to those procedures that are used to restrict access to the fee–for–service payment system and its key data files and computer programs. These procedures are critical since the fee–for–service payment system is highly computerized and provides access to practitioners for submitting claims, and to MSP staff for adjudicating and correcting claims and modifying computer programs.

The overall access control is provided by BC Systems through the use of security software. Under this program, MSP has developed user profiles that define what a person is permitted to do. The person also has to use the correct password and user identification to obtain access to the system and data. Electronic access by practitioners for transmitting claims is controlled not only by these procedures but also by the Teleplan number. In our opinion, the above procedures collectively protect the MSP computer system from unauthorized access. We also believe that the procedures in the system for identifying and reviewing attempted unauthorized access are adequate.

Computer Program and Data Changes

Changes in computer programs are required from time to time to meet user needs. For example, new rules or processes may have to be added for determining the validity of services or for improving the processing of claims.

We found the procedures for initiating and testing program changes in the fee–for–service payment system to be generally satisfactory. However, we noted that the actual changes made are not always compared with approved user documentation. And, because programmers who make changes to fee–for–service payment programs are also responsible for transferring them into the processing environment, we believe there is a risk that erroneous or improper changes may be made.

For emergency changes to the fee–for–service computer programs required to be made outside usual working hours, the normal change control procedures cannot always be followed. While such situations are not predictable, it is important to define when emergency changes can be made.

We also noted that the fee–for–service payment system allows some users to access the query and report writing computer program to make enquiries and identify specific data information. Although this program can only be used in a limited number of computer processing activities, it does enable the users to modify claims data without following normal approval and monitoring procedures.

We recommend that MSP improve procedures for reviewing and monitoring changes to computer programs used for processing fee–for–service claims. As well, MSP should also define when emergency program changes can be made, and restrict and monitor the use of query and report writing program. This is to minimize the risk of erroneous or improper changes being made.

Computer Processing

The primary responsibility for ensuring the completeness and accuracy of the fee–for–service payment data rests with the MSP users. Therefore, to ensure that day–to–day processing is complete, accurate, and timely, MSP must maintain formal and documented standards for the effective and orderly operation of the fee–for–service computer system. Documentation of the computer processes is also necessary to provide guidance to staff, particularly when processing problems need to be resolved promptly.

We believe that MSP has developed reasonable procedures for scheduling and monitoring computer processing activities. Reference manuals are available for most programs and MSP maintains documentation in most key activities. However, not all manuals and documentation are current.

We recommend that MSP complete and update documentation for its system activities and procedures. The documentation should be reviewed periodically to ensure that it remains current.

Backup and Recovery

Interruptions to computer system processing can be temporary (such as when there is a power surge or computer equipment failure) or lengthy (such as when there is loss of processing facilities as a result of fire, earthquake, or other disaster). It is therefore, important that essential computer programs and data can be recovered promptly and processing resumed with minimum delay.

Alternative procedures are in place to pay practitioners during a disruption to processing. As well, MSP has an agreement with BC Systems to provide a general backup of databases and assist in the recovery of data and programs required for resuming normal operations. However, MSP has not prepared recovery procedures or a disaster recovery plan outlining the critical data and computer programs and the steps needed to identify the status of processing at the time of disruption, to establish communication links with the alternate site for receiving and processing claims, or to reconstruct processing using backup computer facility, data, and programs. While BC Systems has indicated that it would assist MSP in restoring as much of the fee–for–service payment system as possible, under the current arrangement with BC Systems, it is the responsibility of MSP to have procedures in place to ensure that all data and programs can be recovered in the event of a disaster.

We recommend that MSP develop a disaster recovery plan for the fee–for–service system so that, in a prolonged interruption to data processing, it can promptly recover critical data and programs for the resumption of normal operations. When developed, the plan should be tested periodically to ensure that it works as expected.

This section is continued in Section 12b (Medical Services Plan: Claim Payment Systems).

Click here to proceed to Section 12b.

Medical Services Plan: Claim Payment Systems

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This section is continued from Section 12a.
(Medical Services Plan: Claim Payment Systems)

Alternative Payment System

Background

In most cases, MSP uses the fee–for–service model to pay physicians for services rendered: the physician is paid a standard fee for each medical service provided and the fee is paid directly to the physician.

Under some circumstances, however, an alternative payment method is used to pay for specific physician or clinical services that are provided through an institutional setting, such as a hospital, cancer clinic, or community health care department (collectively referred to as "agencies"). Examples of services funded under this method of payment include hospital emergency or intensive care, radiology, and psychiatric services. The agencies hire physicians to work on salary or for a number of sessions, normally calculated in blocks of 3.5 hours. In turn, MSP reimburses the agencies for the costs incurred in providing the services. Arrangements involving significant amounts of funding are normally made in the form of service agreements.

As with the fee–for–service system, the alternative payment system relies upon agencies to verify the eligibility of patients receiving services, and to deliver the services for which funding has been provided.

For the year ended March 1994, MSP paid $96 million to some 350 agencies under the alternative payment method. During the time of our review, the alternative payment system was in the process of being computerized. Since the new computer system was not operational at the time of our review, we have not commented on it.

Conclusion

We believe that MSP has established reasonable procedures for checking the accuracy of billed amounts and for issuing payments to agencies funded under the alternative payment method. In making these payments, it relies primarily on the agencies for providing the program services approved and for correctly reporting the physician costs incurred.

To obtain more assurance about the appropriateness of these payments, management has identified additional reporting requirements for agencies. In our opinion, however, MSP still needs to obtain adequate patient and service data from all agencies and supplement current procedures with a regular program of review and monitoring procedures.

Findings

Allocating Funds to Programs

The allocation of funds to various agencies for programs under the alternative payment method is normally determined on an annual basis. Funds are allocated first to existing programs before new ones are considered. Existing programs are funded largely on the basis of amounts paid in the previous year. For new programs, agencies must submit their proposals, demonstrating the need, purpose, and cost of the program. MSP relies on the agencies to report all other sources of funding for the same services. Once approved, the annual allocation represents the authorization level up to which agencies may make claims for delivering their programs. In allocating funds to agencies, MSP specifies:

- the number of physicians or sessions approved for payment;
- the rate of pay or fee; and
- the total allocation.

Processing of Claims

For salary and sessional costs incurred, agencies submit monthly claims to MSP for reimbursement. The claims are supported by a list of physicians and, in the case of sessional payments, also by a sessional billing form. The form shows sessional hours worked and is signed by the physician and the agency. Where there is a service agreement between MSP and the agency, MSP issues a payment every month based on the annual contracted amount. Reasonable procedures have been developed by MSP to ensure that claims are accurate and within the amount authorized for that agency. The payment is approved by the appropriate payment and spending authority, and recorded in the accounts.

Review and Monitoring Processes

It is important that appropriate review and monitoring procedures be established to ensure that reimbursements made to agencies are for valid expenditures.

Because services are provided through agencies, review and monitoring procedures for checking the validity of expenditures can be directed at two levels: first, at the agency level, for ensuring the accuracy of the physician positions filled, the sessional hours worked, and the actual costs incurred by the agency for the services approved; and second, at the clinical service level, for ensuring the actual provision of services and sufficiency of these services.

Management recognizes the need for assurance at both levels and has addressed it in part through a number of reporting requirements for agencies.

For salaried and sessional payments, as indicated above, agencies are required to submit, with their claims, information about physicians hired, hours worked, and amounts paid. Similarly, agencies with whom MSP has service agreements are required to report information on physicians employed and their pay on a monthly or quarterly basis. None of the information reported, however, is about patients or the types of services provided.

While the reported information offers a basis for checking the accuracy of a claim or payment amount, we think that MSP needs to ensure periodically that this information is correct. Such checking is, in fact, contemplated where a funding arrangement is made under a service agreement. A standard clause included in all service agreements currently allows the Medical Services Commission to inspect and review accounting records, data, and reports prepared by the agency. In the last year, however, only a limited number of reviews have been completed.

We commented in our 1989 report on the need for better assurance about patient services provided under the alternative method of payment. As a result of these comments and further study by MSP, some revisions to the standard service agreement for alternative payments have recently been made. New service agreements now require agencies to submit periodically data on patients served and services provided. We noted that patient and service data are currently only required where agencies are reimbursed on a service agreement basis. The data, when regularly collected for all alternative payments and validated, would enable management to monitor the service levels for the programs funded. It would also assist MSP in determining if there is any significant duplicate fee–for–service billing by physicians working on a salary or sessional basis.

We recommend that MSP develop a regular program of on–site review procedures to supplement its reporting requirements for agencies funded under the alternative payment method. Consideration should also be given to obtaining sufficient and consistent level of patient and service information for all types of alternative payments to enable proper monitoring of service levels.

Interprovincial and Other Claim Payment Systems

Background

The plan pays for medical care obtained by its beneficiaries during their temporary stay or visit in other parts of the country or outside Canada. It covers only medically required services, not supplementary health care or services of a cosmetic or elective nature. Most interprovincial claims are billed and settled through provincial health plans based on a series of interprovincial agreements, although some claims are submitted directly to MSP by beneficiaries or physicians.

For the year ended March 1994, MSP paid $12.6 million for medical care of its beneficiaries outside the province, and it recovered $16.8 million from other provinces to offset the payments it had made for providing medical services to their residents. About 75% of interprovincial medical payments are between British Columbia, Alberta, and Ontario. Hospital service payments are not included in the above amounts, as they are covered by other health programs outside the scope of our review.

Conclusion

Medical claims for services provided to residents of one province in another province or territory in Canada are billed and settled through provincial health plans based on a series of interprovincial agreements. These agreements reflect the principles of good faith and respect for payment decisions made by provincial health plans. In this way, the administration of interprovincial claims and the provision of client service are facilitated. Accordingly, MSP relies largely on the procedures followed by out–of–province physicians and health plans to ensure that payments for medical services obtained by MSP beneficiaries when in other provinces are valid and correct. We believe, however, that MSP should periodically find out how well these procedures are actually working.

Where payments are made directly to beneficiaries to reimburse them for medical costs incurred (primarily these are incurred outside Canada or in the province of Quebec), MSP needs to ensure that its policy for obtaining original documents or receipts to support claims is always complied with.

Findings

Payments to Other Provinces

In 1988, MSP and most other provincial and territorial health plans in Canada developed a framework for streamlining the processing and payment of medical claims between provinces and territories. Within this framework, for example, a physician in Alberta providing services to a British Columbia beneficiary travelling in that province would normally submit a bill to the provincial health plan in Alberta, rather than to the patient or MSP. Alberta (the “host province”) would pay the physician and then seek reimbursement from British Columbia. Reimbursements are made at the fee–for–service rates applicable in the host province. Similar procedures are followed when residents of other provinces receive medical care in British Columbia. Residents covered under these arrangements are generally considered eligible to receive medical care upon presentation of a valid health identification card.

For the timely and efficient operation of the interprovincial billing system, the participants have agreed to be guided by two basic tenets: first, the presumption of good faith on the part of host province physicians and health plans; and, second, the acceptance of host province authority. Significant reliance is therefore placed on host province physicians and health plans for ensuring that patients and services are eligible and that billed amounts are correct.

As much as possible, the host provinces have agreed to process claims for out–of–province residents through the same edit, assessment, recording, and payment procedures that they use for their own in-province claims. This means that MSP tends to perform little supplementary checking of claims billed to it by other jurisdictions.

Thus, there is some risk of payments being made for ineligible beneficiaries, ineligible services, and inaccurate claims. For example, an out–of–province physician confirms a patient’s resident status and MSP coverage by seeing that the card presented is a British Columbia CareCard. However, mere possession of the card does not always mean that the person is a current resident of British Columbia or has current MSP coverage. The cardholder’s MSP coverage may have lapsed because he or she did not pay the premiums or made a permanent move from British Columbia; or the person could be using the card mistakenly or improperly in another province. In such cases, payment for ineligible persons may occur.

Management is fully aware of the nature of risks referred to above. We found that the MSP system often identifies errors relating to beneficiary identification when it processes claims from other provinces. The results are not analyzed, however, to find out whether the host province's procedures are sufficiently effective for MSP purposes.

We recommend that MSP periodically determine the effectiveness of procedures used by other provinces to process claims for services provided to MSP beneficiaries.

Payments to Beneficiaries and Physicians

Sometimes bills or claims for reimbursement of medical costs are received directly from beneficiaries who have had to pay for medical care themselves, or from practitioners who provided the care. This is common for medical services obtained by beneficiaries outside Canada or in Quebec, a province not currently participating in the interprovincial billing arrangements. Some of these services may have received prior approval by MSP, but most of them are obtained by beneficiaries for unexpected emergencies.

We found that MSP has established reasonable procedures for ensuring that payments for pre–approved medical services outside the province are valid and correct. However, for other payments made directly to beneficiaries to reimburse them for medical costs incurred outside the province, MSP does not always ensure that its policy of obtaining original documents or receipts to support claims is complied with. As a result, it cannot properly assess the validity of all such claims.

We recommend that MSP comply with its policy of obtaining original documents or receipts to support claims submitted by beneficiaries for reimbursement of medical costs incurred outside the province.

Medical Services Provided to Residents of Other Provinces

Claims for medical services provided by British Columbia physicians to visitors from other provinces are processed through the fee–for–service payment system discussed earlier. The strengths and weaknesses of that system also apply here. Since the cost of these claims is fully recoverable from other provinces, the primary concern should be to ensure that all such claims are properly identified. We found that MSP has satisfactory procedures to do this, coding and sorting them by provinces and seeing that the amounts are fully recovered.

Comments on the Agreement with Physicians

Background

Over the past few years, the government has been working with the public and medical profession to increase their participation in the management of the plan. This is to ensure that all parties are involved in the setting of policy objectives and the management of funding available for the plan's program expenditures. In the 1993/94 fiscal year, the government entered into a number of fee and funding agreements with several practitioner groups in the province.

The most significant of these agreements is with the British Columbia Medical Association (BCMA), which represents the province's physicians. Fee–for–service payments and benefits issued to physicians make up about 90% of the plan expenditures. The BCMA agreement was signed in December 1993 and applies to all physicians who provide medical care on a fee–for–service or a sessional basis under the plan. The agreement sets out fee increases and benefits to be paid, and includes many monetary and non–monetary initiatives intended to limit growth in MSP expenditures. The financial terms between the parties have been determined for five years to March 1997, though the framework contained in the master agreement is to continue for a further three years. As many important provisions under the agreement have yet to come into effect, the focus of our review was to outline and comment on its financial components.

Conclusion

The BCMA agreement contains many complex and sensitive issues, with some important provisions stated only in general terms. The government has two difficult tasks:

- first, of ensuring that parties have a common understanding of the provisions in the agreement and so reducing the risk of disputes and unmet obligations; and
- second, of developing effective methods for measuring the extent to which expenditure reductions that are expected under the agreement have actually been achieved.

In our opinion, the nature and scope of some provisions and expenditure reduction initiatives under the agreement are so unclear and wide ranging that it is questionable whether their results can be monitored and measured in a conclusive manner.

Findings

Key Financial Components of the BCMA Agreement

Exhibit 9.5 provides an overview of the financial components of the BCMA agreement and explains its focus—that is, to reduce $383 million in fee–for–service medical costs over the fiscal years 1993 to 1997. Exhibit 9.6 shows further details of these components for each of the five years, highlighting the expenditure reduction initiatives, their intended monetary effect, and the parties responsible for achieving the reductions.

Exhibit 9.5

The British Columbia Medical Association Agreement, 1993 to 1997

An overview of the financial components of the BCMA agreement ($ Millions)

The government is projecting total fee–for–service medical costs over fiscal years 1993 to 1997 to be	6,838
But it wants to limit the total costs to what the agreement defines as the "Available Amount" of	6,455
Therefore, the costs have to be reduced by	383
To achieve the reduction needed, the parties agreed to undertake a number of "expenditure reduction initiatives."	

Source: The BCMA agreement

Projected Fee–for–Service Medical Costs

The agreement projects fee–for–service medical costs to increase annually over its five–year term by between 5.2 and 6.4%. These increases are to account for a projected growth in fee rates from 1.5 to 2.0%; a growth in population from 2.0 to 2.5%; an increase in aging from 0.8 to 1.0%; and an increase in service usage of 1.5%.

The Available Amount

The "Available Amount" represents a funding level that has been allocated under the agreement for determining fee–for–service payments to physicians in a given year. It is a threshold amount, subject to a number of adjustments that may arise from:

- differences between the projected and actual increase in population, and in the Consumer Price Index;
- transfers of physicians between those who are paid on the fee–for–service basis and those on alternative payment basis;
- costs attributable to disasters or province–wide epidemics; and
- costs attributable to new medical programs and initiatives by the government.

Any shortfall in meeting the expenditure reductions expected under the agreement might also result in a revision to the Available Amount for that year.

Accountability for Shortfall in Meeting Expenditure Reduction Targets

As shown in Exhibit 9.6, the government and Medical Services Commission are responsible for implementing initiatives to reduce expenditures by $340 million, or 89% of the total reduction proposed under the agreement. The physicians, on the other hand, are responsible for reductions totalling $45 million.

If the actual fee–for–service medical expenditure for a given year exceeds the Available Amount, after being adjusted for items such as those listed above, the parties would be considered to have failed

Exhibit 9.6

The British Columbia Medical Association Agreement, 1993 to 1997

Details of key financial components of the BCMA agreement ($ Millions)

Fiscal years ending March 31	1993	1994	1995	1996	1997	Totals
Projected fee–for–service medical claims costs	1,216.0	1,278.9	1,360.0	1,444.8	1,537.9	6,837.6
Available Amounts – the annual base funds to be allocated for fee–for–service medical claim payments to physicians	1,216.0	1,278.9	1,298.1	1,317.6	1,343.9	6,454.5
Expenditure reductions required	–	–	61.9	127.2	194.0	383.1
Expenditure reductions to be achieved through initiatives that are the responsibility of:						
Government and the Medical Services Commission						
Allocating all motor vehicle accident–related costs to the Insurance Corporation of British Columbia and reducing charges from hospitals and other agencies	–	–	(50.0)	(50.0)	(50.0)	
Promoting public awareness of health issues and costs	–	–	–	(10.0)	(20.0)	
Removing coverage of certain services and categories of beneficiaries	–	–	–	(10.0)	(20.0)	
Setting diagnostic protocols and clinical practice guidelines	–	–	(10.0)	(40.0)	(80.0)	
	–	–	(60.0)	(110.0)	(170.0)	(340.0)
BCMA and physicians						
Assisting in the public education program noted above	–	–	–	(10.0)	(20.0)	
Assisting in the auditing and inspection of medical claims and practitioners' patterns of practice	–	–	–	(5.0)	(10.0)	
	–	–	–	(15.0)	(30.0)	(45.0)
Residual adjustments	–	–	(1.9)	(2.2)	6.0	1.9
Total of expenditure reduction initiatives	–	–	(61.9)	(127.2)	(194.0)	(383.1)

Source: The BCMA agreement

in achieving the expenditure reductions in accordance with the agreement. Attempts would then be made to identify and quantify portions of the excess amount that could be attributed to individual initiatives and to the parties.

Where the government or Medical Services Commission is held accountable for the excess, the excess sum would be regarded as an increase in the Available Amount. That sum, as part of actual expenditure, would have already been paid to physicians.

Where the BCMA or physicians are held accountable for the excess, a recovery would be made from a reserve account before any pro–rating of fees payable to physicians is considered. The agreement requires that the government make a total contribution of $11 million to establish the account. The account is also to be used for recording any amount by which the actual expenditure is less than the Available Amount. The total amount accumulated in this account is to be held for the benefit of physicians.

For the 1993/94 fiscal year, the portion of fee–for–service medical claims expenditure subject to the BCMA agreement was $1,284 million. This amount exceeds the projected claims cost and the Available Amount for the year by about $5 million. While the accounting required under the agreement for 1993/94 has not yet been finalized, preliminary calculations indicate that adjustments currently known may increase the Available Amount by between $1 million and $5 million. The cost of new programs and initiatives for which the government has direct responsibilities has yet to be identified and calculated.

Scope of Expenditure Reduction Initiatives and Other Provisions

As is evident from Exhibit 9.6, the agreement does not require an accounting for cost reductions until the 1995 fiscal year or later. This was to allow the government and Medical Services Commission to develop a framework of policies and methods for measuring the financial results of expenditure reduction initiatives. Such a framework is needed to ensure proper accountability under the agreement. We briefly comment below on the nature, scope, and measurement issues arising under the main provisions of the agreement.

New programs and initiatives

The agreement states that "in the event that the government implements new medical programs which directly affect the cost of insured medical services," these costs will be borne by the government. Also, the cost of "any initiatives proposed by government, a regional health board or a community health council that result in increased utilization" will not be the responsibility of physicians. In our opinion, the above terms and some other provisions in the agreement are so general and wide ranging that it would be onerous for the government to refute any claims made by the BCMA or physicians that link those terms with increased use of medical services. We understand that the government is currently working with the physicians to ensure they have a common understanding of the provisions of the agreement and, more particularly, to resolve differences in their interpretation of "new programs and initiatives."

Allocating costs to the Insurance Corporation of British Columbia (ICBC)

Until now, the government has billed ICBC for medical and supplementary health care costs only where such costs related to motor vehicle injury claims covered by third party liability insurance. The medical portion of these costs in 1993/94 was about $12 million. Under the BCMA agreement, the government plans to recover an estimated amount of up to $30 million a year by billing ICBC for medical costs arising from all car accidents, and by determining these costs on an individual service basis. The government has developed guidelines for identifying such costs, thus the calculation of actual additional billing to ICBC is likely to be relatively simple. The allocation is essentially a transfer of costs to ICBC.

Reducing charges from hospitals and other agencies

The government is to ensure that medical services that may already be funded or should be funded by other government programs are not billed to MSP by the institutions. The government estimates that this initiative should reduce MSP costs by about $20 million, and it is generally aware of the services involved. Determining the actual reductions achieved would be relatively simple. The hospitals and agencies are likely to look to the government for funding to cover any revenue shortfall they may face as a result of this initiative. If this happens, the initiative would have no effect on overall public sector expenditure.

Promoting public awareness of health issues and costs

The goal of the initiative is to reduce unnecessary and inappropriate use of the health care system by making the public more aware of the health issues and costs. We were told that a study is under way to help the government in planning and preparing for a public education program. The effect of this initiative on expenditures is likely to be particularly difficult to monitor and measure. Changes in public awareness, attitudes, and behavior mostly occur gradually. Thus, their effect can only be meaningfully discerned over a long period of time, likely much longer than the term of the BCMA agreement.

Removing coverage of services and beneficiaries

The government has yet to determine which services or beneficiaries should be restricted or no longer covered under the plan. This initiative involves identifying services that are considered not medically necessary and groups of non–Canadians who are no longer eligible for coverage under the plan. We understand that the government plans to analyze historical data fully to assess the probable impact on expenditures of various options under this initiative.

Setting diagnostic protocols and clinical practice guidelines

This initiative would require the parties to define medically necessary services within the context of medical, legal, and public policy considerations. The issues are expected to be complex and sensitive. We understand that a general framework for developing protocols and guidelines and evaluating their effects has been approved. As in the public education program, we believe the task of making a direct linkage between the cause and effect of this initiative may prove demanding.

Physician Benefit Plans

Another important financial component contained in the agreement relates to the physician benefit plans. Exhibit 9.7 sets out the government's contribution to physician benefit plans over the fiscal years 1993 to 1997. The contribution of $25 million to the professional retirement savings plan is a new benefit started in the 1994 fiscal year. Other benefit plans have been in effect for a number of years.

Exhibit 9.7

Government Contributions to Physician Benefit Plans under the BCMA Agreement, 1993 to 1997

($ Millions)

	1993	1994	1995	1996	1997
Continuing medical education program	6.1	6.6	6.6	6.6	6.6
Physicians' disability insurance program	6.3	6.3	8.0	8.0	8.0
Canadian Medical Protective Association rebate program	11.0	12.8	13.5	14.2	15.0
Contributory professional retirement savings plan	–	25.0	25.0	25.0	25.0
Total	23.4	50.7	53.1	53.8	54.6

Source: The BCMA agreement

Response of the Medical Services Commission

Medical Services Plan: Claim Payment Systems

The Medical Services Commission appreciates the opportunity to comment on the Auditor General's review of the Medical Services Plan's claims payment system.

British Columbia's system of Medicare operates in a unique relationship of trust between government, the beneficiaries and practitioners. The Commission agrees, however the controls are essential in order to protect the integrity of the system.

The Medical Services Plan has developed an electronic claims processing system which accounts for the adjudication and payment authorization of over 97% of the 53 million claims received. This system, which has won international recognition, provides a high degree of consistency and accuracy in the adjudication of claims with the added benefit of confidentially of sensitive information.

The Commission agrees with the recommendations for improvements in the process of beneficiary registration. In this regard the Medical Services Plan has initiated a project to oversee the re–engineering of its registration and premium billing system, using many of the proven techniques used in the development of its claims processing system. This review will include an examination of measures to reduce fraud including the feasibility of a photo identification card.

The Plan has expanded the audit program which conducts on–site audits to examine the billing practices of enrolled practitioners. This audit program has the active participation and support of the professional licensing bodies and associations representing those practitioners enrolled in the Plan.

The Commission agrees with the need for disaster recovery plans and has asked the Medical Services Plan to evaluate options for improvements in this area.

The Master and Working Agreements between the British Columbia Medical Association (BCMA), the Medical Services Commission (MSC) and the Government of British Columbia, provide an innovative and essential framework for jointly setting policy objectives and co–managing the medical fee–for–service budget of the Medical Services Plan. Integral to the agreements are provisions for establishing a working partnership and collaboration between the parties, and for fostering a strong commitment toward better monitoring and management of expenditures for physician services.

The value of the agreements lies in the acknowledgment by all parties that an active partnership is required for managing a fixed budget for medical services and the recognition of the need for implementing specific expenditure reduction initiatives to keep within the set budget. In applying assigned dollar amounts to those initiatives, the agreement provides operational targets and provides the impetus for hastening the implementation of specific initiatives.

The Commission accepts that conclusive measurement of achievements in expenditure reductions may be challenging. A basis for the shared responsibility for cost–containment initiatives, however, introduces a greater degree of public accountability on the part of government and physicians with respect to funding and management of medical services.

Updated Responses to Last Year's Internal Control and Other Reviews

Office of the Comptroller General

New Corporate Accounting System (CAS)

A review of the adequacy of the internal controls built into the new corporate accounting system

Page 75 of this report contains a review of CAS performed by our office this year. The section is entitled "New Corporate Accounting System: Update." Because of the significant effect that CAS will have on government financial accounting processes and reporting, we believe it is important that we monitor the system as it is being developed. A response from the Office of the Comptroller General is included with that report, on page 84.

Revenue Accounting Policies

A review of the appropriateness of the policies used to account for revenue in the government's financial statements

During fiscal 1993/94, the province changed its basis of recognizing personal income taxes and established programs financing entitlements. Previously, these revenues were reported on the basis of cash received during the fiscal year from the federal government based on their estimate of amounts due to the Province of British Columbia. The province now estimates these revenues on the basis of more accurate information of the province's entitlements.

Due to other pressing issues, we were not able to review the recording of licenses and permits revenue before March 31, 1994. However, we are currently working on this review which will result in a recommendation of the most appropriate accounting treatment.

We also did not include a note disclosure on requirements for government enterprises to pay (or not pay) their net income to the province. This information will be disclosed in the 1994/95 Public Accounts.

Superannuation Commission

Pension Information on Payment System

A review of controls over the disbursement of pension benefits to retired public sector employees

In our initial response last year we noted that we had acted on a number of recommendations by the Auditor General. In addition, we indicated that we would consider the recommendations of the Auditor General in the planned comprehensive review and reorganization of Commission functions and systems redesign to be undertaken over the next few years (including the pension calculations and payment function).

We have recently moved ahead in our planning process, with significant changes in the pension calculation and payment function intended over the next several months. While some of the specific recommendations by the Auditor General may no longer be relevant as a result of the reorganization, the principles of financial control which underly those recommendations have been taken into account. We also anticipate working closely with the staff of the Auditor General's Office over the next few years as we proceed in our reorganization and systems redesign, to ensure that the appropriate procedural and systems controls are in place.

Ministry of Education

Improving the Financial Accountability of School Districts

A review of instruction provided to school districts for preparing their annual financial statements and the process for appointing their auditor

During the past year the Ministry of Education has made further changes to address the comments of the Auditor General in his 1993/94 report.

An updated accounting manual for school districts was issued for 1994/95 and encumbrance accounting is no longer acceptable for recording district expenditures.

A Ministerial Order was made in 1994 to require all boards to report specific consistent financial information on their annual reports. The School Act *was also amended to allow a ministerial order for establishing a consistent procedure for appointing the school district auditor to further enhance the auditor's independence.*

Audit of Financial Statements of Government Entities, Trust Funds, and Other Organizations

Section contents

Audit of Financial Statements of Government Entities, Trust Funds, and Other Organizations

General

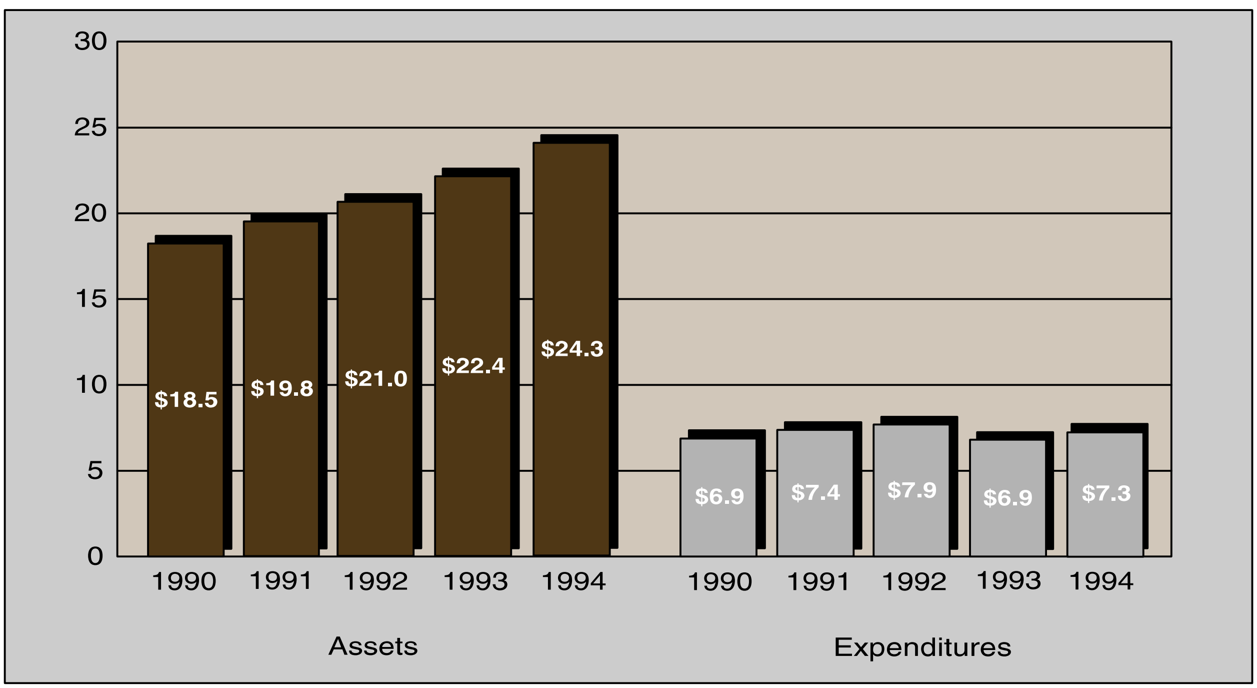
The government Summary Financial Statements for the 1993/94 fiscal year include the results of the financial activities and operations of the Consolidated Revenue Fund and 41 other government organizations and enterprises. The latter are owned or controlled by the government and are accountable in the administration of their financial affairs and resources either to a minister of the government or directly to the legislature.

In the 1993/94 fiscal year, the assets and expenditures of these 41 government organizations and enterprises (collectively referred to

Exhibit 10.1

Changes in Assets and Expenditures

Assets and expenditures of government entities, 1990 to 1994 ($ Billions)



Source: Financial statements of government entities in this section as government entities) amounted to $24.3 billion and $7.3 billion, respectively. Exhibit 10.1 shows the asset and expenditure amounts of these government entities from 1990 to 1994.

The number of government entities increased from 33 to 41 over the five years to 1994. Ten newly incorporated entities were added and five were removed because they had ceased operations. A further four entities were added and one was removed when the government reporting entity criteria were applied to the government organizations and enterprises, as part of the government's ongoing review to determine the composition of the reporting entity.

Entities included in the 1993/94 Summary Financial Statements for the first time are the B.C. Transportation Financing Authority and the Pacific Racing Association, both of which were incorporated during the year, and the British Columbia Rapid Transit Company Ltd., an existing entity, which has been identified as appropriate for inclusion.

The British Columbia Housing and Employment Development Financing Authority, the British Columbia Year of Music Society, and the Cloverdale Historic Transportation Society of B.C. ceased operations during the 1992/93 fiscal year and have therefore not been included in the Summary Financial Statements this year. The Hospital Foundation of British Columbia has also been removed for the current year.

The Plain Language Institute of British Columbia Society, The Education Technology Centre of British Columbia, the 178561 B.C. Ltd., and the British Columbia Hazardous Waste Management Corporation were dissolved during the 1993/94 fiscal year. The financial results of their operations to the date of dissolution have been included in this year's Summary Financial Statements.

Exhibit 10.2 shows, for the government entities included in the 1993/94 Summary Financial Statements, the asset and expenditure amounts audited by private sector accounting firms and those audited by the Auditor General. Private sector accounting firms audited 29 government entities, which had combined assets of $20.1 billion and expenditures of $6.9 billion. The Auditor General audited 11 such entities, with total assets of $4.2 billion and expenditures of $0.4 billion. One small entity was not audited.

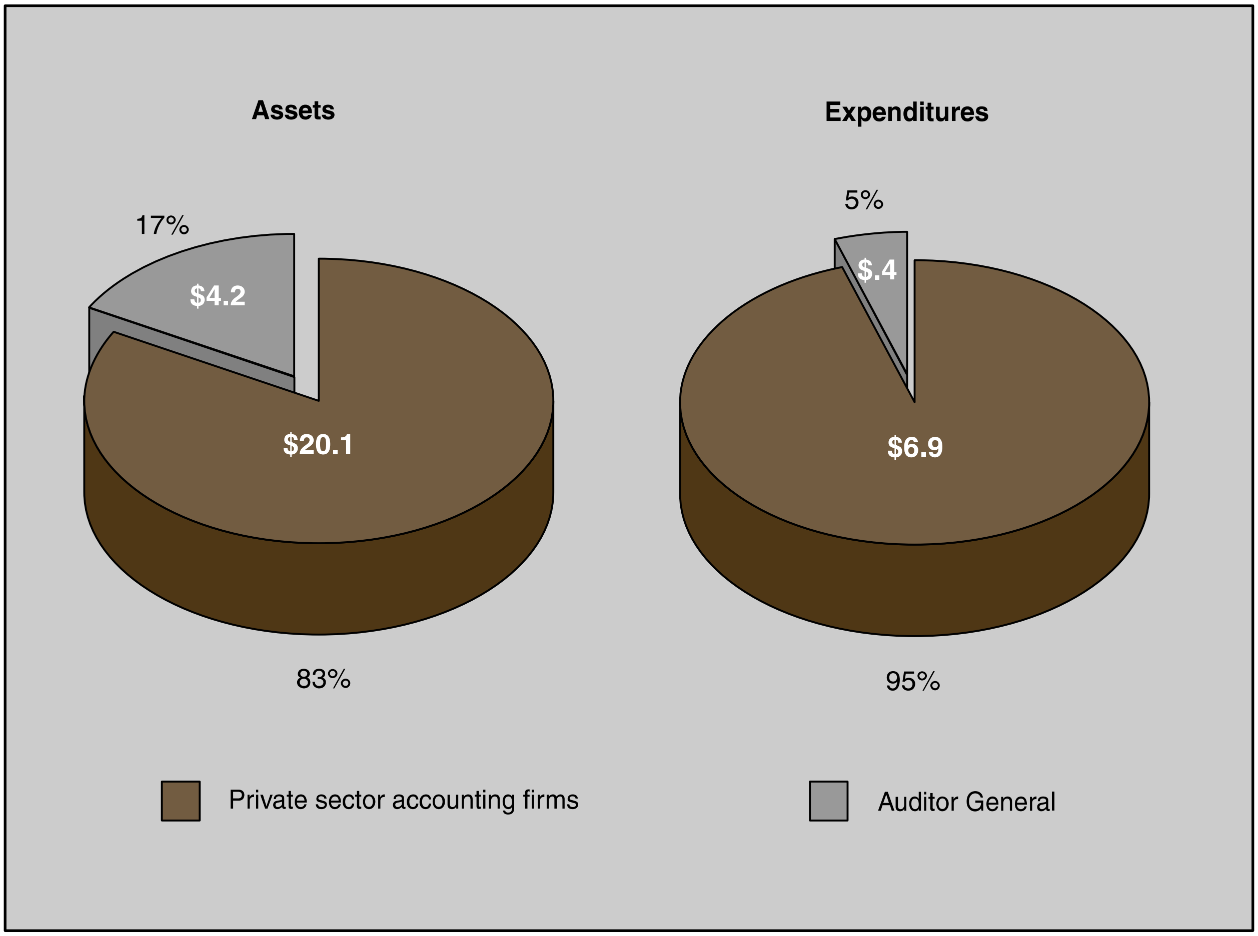
In addition to the government entities, the Auditor General audited a further 37 organizations with assets of $38.5 billion and expenditures (including financing transactions) of $21.1 billion. Among these were 24 trust funds, including pension and superannuation plans and investment funds administered by the government.

Appendix B of this report lists all government entities audited by the Auditor General, as well as the other organizations and trust funds audited by the Auditor General which are not included in

Exhibit 10.2

Distribution of Financial Statement Attest Audits

Asset and expenditure amounts audited by private sector accounting firms and by the Auditor General (for government entities), 1993/94 ($ Billions)



Source: Financial statements of government entities

the Summary Financial Statements. Three new Province of British Columbia Pooled Investment Portfolios have been added this year, as well as one superannuation plan. Appendix C lists the government entities that were either audited by private sector accounting firms or were unaudited, and whose financial statements are included in the Summary Financial Statements.

Audit Reporting on Government Entities, Trust Funds, and Other Organizations

Both the management and the auditor of a government entity have responsibilities associated with that entity's financial statements. Management is responsible for preparing financial statements, establishing their form and content, and determining the accounting policies that are appropriate for the organization's activities. The auditor's responsibility is to express an opinion as to whether the financial statements present fairly, in all material respects, the financial position and operating results of the entity in accordance with appropriate accounting principles.

During this past year, each auditor's report on the financial statements of government entities included in the government Summary Financial Statements was issued without reservation. In the case of one small entity, the auditor's report included reference to the nature of revenue that was not susceptible to satisfactory audit verification.

When our annual audit work is finished, we write to the management of each government entity to advise them of any audit concerns we have. Where appropriate, we also make recommendations for remedial action. If a reported matter is considered to be significant, we may comment on that issue in our report to the Legislative Assembly, to help in the improvement of the management of government operations, programs, and systems. We can confirm that significant matters raised through these management letters in the past year are being satisfactorily dealt with.

Accounting Standards for Not–for–profit Organizations

In recent reports, we have commented on the progress made by the Canadian Institute of Chartered Accountants (CICA) and its associates in developing accounting standards for not–for–profit organizations. The standards are relevant to many of the organizations identified in this section, as they define generally accepted accounting principles (GAAP) for these entities. The purpose of GAAP is to provide a basis for the preparation of financial statements intended to present fairly an organization's financial position and the results of its activities.

The accounting recommendations in the CICA Handbook have applied to not-for-profit organizations for a number of years. However, the CICA has been working on providing additional guidance to these organizations on the format of the financial statements, as well as on issues relating to content (such as accounting for capital assets, contributions, and the operating results of controlled and related organizations).

In December 1993, the CICA proposed new recommendations on these matters that expanded on original proposals contained in an Exposure Draft issued in 1992. The

CICA is currently evaluating the responses to these new proposals and should be finalizing its accounting recommendations in the near future.

Historically, many organizations in the government not–for–profit sector saw “funds flow” accounting as being the most meaningful way they could present financial accountability information in their general purpose financial reporting. This form of presentation emphasized the reporting of revenues and expenditures in the period in which the transactions occurred, and was primarily intended to demonstrate the organization’s proper stewardship of the funds given to it. Allocating all of the expenditures to each of the accounting periods they were deemed to benefit was not considered necessary, as such an allocation had no direct relevance to the stewardship responsibility.

However, the CICA considers that users of not–for–profit financial statements are primarily interested in knowing the cost of providing services during the reporting period. Accordingly, the CICA Handbook recommendations called for the allocation of costs to the reporting period when the related resources were consumed in providing services.

To comply with this, many not–for–profit organizations needed to change their accounting policies to ensure that their financial reporting adhered to GAAP. The policies most affected by the change include those for recognizing compensated absences, such as vacation pay, sick pay, and early retirement allowances, and for determining the employer cost of certain types of pension contributions.

Many organizations made changes to their basis of accounting immediately, but some did not. In several cases, there was no change because legislation or governmental funding agencies required a basis of accounting other than GAAP. In other cases, not–for–profit organizations preferred to continue with a funds flow form of financial presentation until the CICA had completed its task in codifying GAAP for not–for–profit organizations. Either way, auditors reporting on whether the financial statements of such organizations were in accordance with GAAP had to include a reservation in their audit opinion if the effect of the exceptions to GAAP was considered material. One publicly funded university in British Columbia received such a reservation in the audit opinion attached to its 1993/94 financial statements.

We believe that the CICA’s proposed recommendations will make not–for–profit financial reporting more useful to a broader range of financial statement users. The statement of activities or operations will continue to disclose the cost of providing the organization’s services; the proposal to write off the cost of capital assets over the estimated useful life of the assets should improve the quality of this cost information; and the options for disclosing cash flows will give each not–for–profit organization more opportunity to provide relevant information about the flow of funds through the organization.

In summary, we feel that the proposed recommendations are likely to promote greater consistency in not–for–profit financial reporting in both the private and government sectors.

Funding of Statutory Pension Plans

We have reported in prior years our concern about the funding of the five public sector statutory pension plans. Together they now have accumulated unfunded liabilities of approximately $3.5 billion (see Exhibit 10.3).

Our concern has been that the government is not following its stated funding policy of maintaining unfunded liabilities at a constant percentage of payroll. This concern was also raised by the consulting actuary to the plans, who has continually recommended in his reports that government increase contribution levels in order to meet its funding policy.

The government has taken some positive action in 1994 to address this funding concern with the enactment of Bill 53, the *Pension Statutes Amendment Act, 1994*. Contribution rates under legislation before Bill 53 were fixed for the statutory pension plans, meaning that the legislation had to be amended each time there was to be a change in rates. This made for a somewhat inflexible arrangement and, as a result, rates were rarely changed despite recommendations from the actuary to do so. Bill 53, however, now allows the changing of rates for statutory plans without the need for further legislative amendment. It also goes one step further by requiring contribution rates to be increased when unfunded liabilities rise as a percentage of payroll. We believe Bill 53 partially addresses our concern for the growing funding deficiencies in these pension plans because it at least caps any further increase in deficiencies relative to the size of payroll.

Inflation Indexing

In addition to its new funding provisions, Bill 53 provides for benefit improvements in each of the statutory pension plans. These improvements are to be financed by reducing funding that otherwise would have been set aside for inflation indexing. The government has reported that these improvements will not result in increased unfunded liabilities or additional contributions by the employer. We believe, however, that this reduced funding to the inflation accounts may affect the security of future inflation indexing for contributing plan members.

Each statutory pension plan provides inflation indexing from a special account that is funded through employer and employee contributions. Legislation covering each plan provides for inflation indexing only if there is money available in this special account to do so. Presumably, if there were a shortfall in this account in a given year, only partial indexing would result. Such a situation has not occurred since the inception of the inflation accounts in 1982.

We believe that many plan members currently contributing into the special accounts expect to receive fully indexed benefits following retirement. Given that there is no guarantee that full indexing will be paid, we urge the government, through the Superannuation Commission, to advise plan members regularly on the current status of the special accounts. This can be best achieved through regular actuarial valuations.

We recommend that the government regularly advise statutory pension plan members on the current status of the inflation indexing accounts through regular actuarial valuations.

Exhibit 10.3

Summary of Public Service Statutory Pension Plans' Unfunded Liability

($ Millions)

	Valuation				
	Prior deficit	Latest deficit	Latest date	Change (decrease) increase	Additional contributions recommended by the actuary[1]
Public Service Superannuation Plan	438	193	Mar. 31, 1993	(245)	–
Municipal Superannuation Plan	1,082	1,411	Dec. 31, 1991	329	1.49%
Teachers' Pension Plan	1,605	1,879	Dec. 31, 1990	274	1.53%
College Pension Plan	30	45	Aug. 31, 1991	15	1.81%

No valuation was performed on the Members of the Legislative Assembly Superannuation Account. Amounts contributed are transferred to the Public Service Superannuation Plan when MLAs retire. Any shortfall between amounts held in the account and the benefits earned by MLAs at the retirement date is paid by the government into the plan. Pension benefits are then paid to MLAs through the plan.

[1]Combined employer and employee rates

Source: Plan financial statements and actuarial reports

Reporting the Funding Progress of Statutory Pension Plans

We believe the government should be reporting to the public on the funding progress of the statutory pension plans under its administration. Reporting historical trend information over time will assist the public in assessing the potential future impact of the plans on contributors and taxpayers. The current emphasis is on the financial strength of the plans at a point in time. This can be misleading. Information about the financial strength is more useful, and less subject to misinterpretation, when presented for several consecutive periods of time.

Two ratios that provide information about whether the financial strength of a pension plan is improving or deteriorating over time are the funded ratio and the ratio of the unfunded actuarial liability to payroll (see Exhibit 10.4). An improvement is indicated when the funded ratio is increasing and the ratio of the unfunded actuarial liability to payroll is decreasing.

We recommend that the government report to the public on the funding progress of the statutory pension plans under its administration.

We note that these ratios cannot be calculated for the Members of the Legislative Assembly Pension Plan because actuarial valuations are not performed for it. We suggest, as an alternative, that the government provide historical trend information on the additional terminal funding that has been required for this plan. Terminal funding is the additional funding provided by the government in the years that pensions are granted, and is needed because accumulated contributions in the plan for the retiring members are usually less than the value of the pensions granted.

Exhibit 10.4

Schedules of Funding Progress

($ Millions)

Pension Plan	Actuarial Valuation Date	(a) Actuarial Value of Assets	(b) Actuarial Liability	(c) Unfunded Actuarial Liability (UAL)	Funded Percentage (a/b)	(d) Covered Payroll	UAL as a Percentage of Payroll (c/d)
Public Service	3/31/87	4,024	4,480	(456)	89.82	1,214	37.56
	3/31/90	5,009	5,447	(438)	91.96	1,388	31.56
	3/31/93	6,896	7,089	(193)	97.28	1,839	10.49
Teachers’	12/31/84	3,554	4,946	(1,392)	71.86	1,056	131.82
	12/31/87	4,248	5,853	(1,605)	72.58	1,167	137.53
	12/31/90	5,682	7,561	(1,879)	75.15	1,566	119.99
Municipal	12/31/85	4,143	4,998	(855)	82.89	1,700	50.29
	12/31/88	5,420	6,502	(1,082)	83.36	2,066	52.37
	12/31/91	7,937	9,348	(1,411)	84.91	2,846	49.58
College	8/31/85	249	310	(61)	80.32	100	61.00
	3/31/88	342	372	(30)	91.94	119	25.21
	3/31/91	521	566	(45)	92.05	204	22.06

Note: Above based on level contribution method – statutory basis

Members of the Legislative Assembly	Year	Accumulated Contributions Available for Pensions Granted $	Terminal Funding Received from the Province $	Present Value of Pensions Granted $
	1985	.5	–	.5
	1986	–	–	–
	1987	2.5	6.9	9.4
	1988	.4	.6	1.0
	1989	.3	.6	.9
	1990	.5	.6	1.1
	1991	.3	–	.3
	1992	2.8	6.4	9.2
	1993	–	–	–
	1994	.2	.4	.6
		7.5	15.5	23.0

Source: Pension plan financial statements

Appendix A

Financial Statement Audit Objectives and Methodology, Office of the Auditor General

Purposes of Financial Statement Audits

An independent audit of financial statements has several purposes. The main one is to add credibility to the statements, thus enhancing their value to the ultimate users. Evidence of this is provided in the form of an Auditor's Report which accompanies the financial statements, and in which the auditor's opinion expresses whether the statements are presented fairly in accordance with an appropriate, disclosed basis of accounting.

Another benefit of such an annual audit is that its very existence provides a constant stimulus to an organization to ensure sound financial management. In addition, the auditor is frequently able to provide helpful assistance and advice to an organization as a direct result of findings developed during the audit.

Reporting the Results of Audits

As noted above, a financial statement audit results in the issuance of a report on those statements. These reports are addressed to whoever appointed or engaged the auditor to do the work, such as the organization's owner, the shareholders, or some appropriate representative of those with a stake in the organization. In the case of the government financial statements examined by this Office, the Auditor General addresses his or her reports to the Legislative Assembly. The reports issued on the statements of Crown corporations and other government organizations are addressed to various parties, according to applicable appointment or engagement arrangements.

The Auditor's Report constitutes the auditor's professional opinion on the financial statements, and usually consists of three paragraphs.

The first paragraph identifies the financial statements that have been audited. It also points out that the statements are the responsibility of management, and that the auditor's responsibility is to express an opinion on the statements.

Next is the "scope" paragraph, which describes the nature and extent of the auditor's work and the degree of assurance that the Auditor's Report provides. Also, it refers to generally accepted auditing standards and describes some of the important procedures which the auditor undertakes.

The third paragraph, frequently referred to as the "opinion" paragraph, contains the auditor's conclusion based on the audit conducted.

If the auditor is unable to provide an opinion without reservation on the financial statements, the report must include another paragraph. In that paragraph, which would appear between the scope and the opinion paragraphs, the auditor advises the reader as to the reasons for the reservation, and the effects or possible effects on the financial statements of the matters giving rise to the reservation.

Finally, should the auditor wish to present additional information or explanations concerning the financial statements—information that does not constitute a reservation in the audit opinion—this will appear in a further, explanatory paragraph to the report.

Auditing Standards

When undertaking examination procedures for the purpose of expressing an opinion on financial statements, auditors are expected to comply with established professional standards, referred to as generally accepted auditing standards. The principal source of these standards in Canada is the Canadian Institute of Chartered Accountants (CICA).

Generally accepted auditing standards consist of three main areas. There are general requirements that the auditor be properly qualified to conduct and report on an audit, and that he or she carry out the duties with an objective state of mind. Further standards outline the key technical elements to be observed in the conduct of an audit. Finally, reporting standards set out the essential framework of the Auditor's Report on the financial statements.

In addition to these broad standards, the CICA makes other, more detailed, recommendations related to matters of auditing practice. As well, the CICA, through its Public Sector Accounting and Auditing Board, makes recommendations that relate specifically to the audit of entities in the public sector.

Application of the Standards

We carry out extensive examinations of the accounts and records maintained by the ministries and central agencies of government, and by the Crown corporations and other public bodies of which the Auditor General is the auditor.

Also, with respect to Crown corporations which are audited by other auditors and which form part of the government's Summary Financial Statements, we obtain various information and assurances from those other auditors which enable us to rely on their work in conducting our audit of the government's accounts. This information is supplemented by periodic reviews by our staff of those auditors' working paper files and audit procedures.

Throughout these examinations, the Office of the Auditor General complies with all prescribed auditing standards in the conduct of its work. It must be realized, however, that the Auditor General's opinion on a set of financial statements does not guarantee the absolute accuracy of those statements. In the audit of any large organization it is neither feasible nor economically desirable to examine every transaction. Instead, the auditor, using a knowledge of an organization's business, methods of operation, and systems of internal control, assesses the risk of error occurring and then designs audit procedures to provide reasonable assurance that any errors contained in the financial statements are not, in total, significant enough to mislead the reader as to the organization's financial position or results of operations.

When determining the nature and extent of work required to provide such assurance, we consider two main factors: *materiality*, which is expressed in dollar terms, and *overall audit assurance*, expressed in percentage terms.

- *Materiality* relates to the aggregate dollar amount which, if in error, would affect the substance of the information reported in the financial statements, to the extent that a knowledgeable reader's judgment, based on the information contained in the statements, would be influenced.

  In our audit of the government financial statements we have assumed that an error in the current year's deficit in excess of one–half of 1% of the gross expenditure of the government would be considered material. For our audits of government organizations, materiality is established based on the nature of the organization and an appropriate percentage, or combination of percentages, of expenditure, assets, or surplus/deficit.

- *Overall audit assurance* represents, in percentage terms, how certain the auditor wants to be that the audit will discover error in the financial statements which, in total, exceeds materiality, should such total error exist.

In our audit of the government financial statements, we planned our work so as to achieve an overall audit assurance of 97.5% that the audit would detect error in excess of materiality. For our audits of other government organizations, our planned overall audit assurance ranges between 95% and 97.5%. In choosing the level of assurance, we consider factors such as the expectations of the users of the financial statements and the nature of the audit evidence available.

In planning our audits of financial statements, we exercise professional judgment in determining the application of these two key factors. Professional judgment is influenced by our knowledge of the requirements of readers of the financial statements, and by what is generally accepted as being appropriate by auditors of similar organizations.

Appendix B

Government Entities and Trust Funds Audited by the Auditor General

Entities Included in the Summary Financial Statements

British Columbia Assessment Authority

British Columbia Educational Institutions Capital Financing Authority

British Columbia Enterprise Corporation

British Columbia Health Research Foundation

British Columbia Liquor Distribution Branch [1]

British Columbia Regional Hospital Districts Financing Authority

British Columbia School Districts Capital Financing Authority

Creston Valley Wildlife Management Authority Trust Fund

Duke Point Development Limited

Health Facilities Association of British Columbia

Provincial Capital Commission

W.L.C. Developments Ltd.

Other Entities

British Columbia Institute of Technology

Legal Services Society

Provincial Employees' Community Services Fund

Simon Fraser University

University of British Columbia

University of Northern British Columbia

University of Victoria

University Foundations:

- Simon Fraser University Foundation
- The University of British Columbia Foundation
- University of Northern British Columbia Foundation
- Foundation for the University of Victoria

University of Northern British Columbia Pension Plan

Workers' Compensation Board Superannuation Fund

Trust Funds

BC Rail Ltd. Pension Plan

British Columbia Hydro and Power Authority Pension Plan

British Columbia Public Service Long Term Disability Plan

College Pension Plan

Members of the Legislative Assembly Superannuation Plan

Municipal Superannuation Plan

Province of British Columbia Pooled Investment Portfolios:

- Active Canadian Equity Fund
- Indexed Canadian Equity Fund
- Customized U.S. Equity Fund

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[1] Branch of Ministry of Attorney General

Appendix D

Excerpts from the 1993/94 Public Accounts

The material that forms Appendix D is from the Public Accounts of British Columbia for the fiscal year ended March 31, 1994. It consists of the government Summary Financial Statements and the Auditor General's Report on them.

- Managed International Equity Fund
- Passive International Equity Fund
- Corporate Bond Fund
- Real Return Bond Fund
- Fund ST1
- Fund ST2
- Fund ST3
- Indexed Government Bond Fund
- Realpool Investment Fund
- Active U.S. Equity Fund
- British Columbia Focus Fund

Public Service Superannuation Plan

Teachers' Pension Plan

Workers' Compensation Board of British Columbia

Westel Pension Plan

Appendix C

Government Entities and Trust Funds Audited by Private Sector Auditors, or Unaudited, and Whose Financial Statements Are Included in the Public Accounts

Entities Included in the Summary Financial Statements

B.C. Health Care Risk Management Society

B.C. Pavilion Corporation

B.C. Rapid Transit Company Limited

B.C. Summer and Winter Games Society

B.C. Transportation Financing Authority

British Columbia Buildings Corporation

British Columbia Ferry Corporation

British Columbia Festival of the Arts Society

British Columbia Hazardous Waste Management Corporation

British Columbia Heritage Trust

British Columbia Housing Management Commission

British Columbia Hydro and Power Authority

British Columbia Lottery Corporation

British Columbia Petroleum Corporation

British Columbia Railway Company

British Columbia Steamship Company (1975) Ltd.

British Columbia Systems Corporation

British Columbia Trade Development Corporation

British Columbia Transit

Downtown Revitalization Program Society of British Columbia

First Peoples' Heritage, Language and Cultural Council

Insurance Corporation of British Columbia

Okanagan Valley Tree Fruit Authority

Pacific National Exhibition

Plain Language Institute of British Columbia Society

Provincial Rental Housing Corporation

Science Council of British Columbia

The Education Technology Centre of British Columbia

178561 B.C. Ltd. (formerly Pacific Coach Lines Ltd.) – *unaudited*

Pacific Racing Association

Trust Fund

Credit Union Deposit Insurance Corporation of British Columbia

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