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OFFICE OF THE
Auditor General
of British Columbia

**Monitoring the
Government's Finances**
Province of British Columbia

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OFFICE OF THE
Auditor General
of British Columbia

**The Honourable Claude Richmond
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
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Dear Sir:

**I have the honour to transmit herewith to the Legislative Assembly
of British Columbia my 2001/02 Report 4: Monitoring the
Government's Finances.**

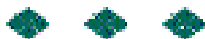
**Wayne Strelloff, CA
Auditor General**

**Victoria, British Columbia
January 2002**

**copy: Mr. E. George MacMinn, Q.C.
Clerk of the Legislative Assembly**

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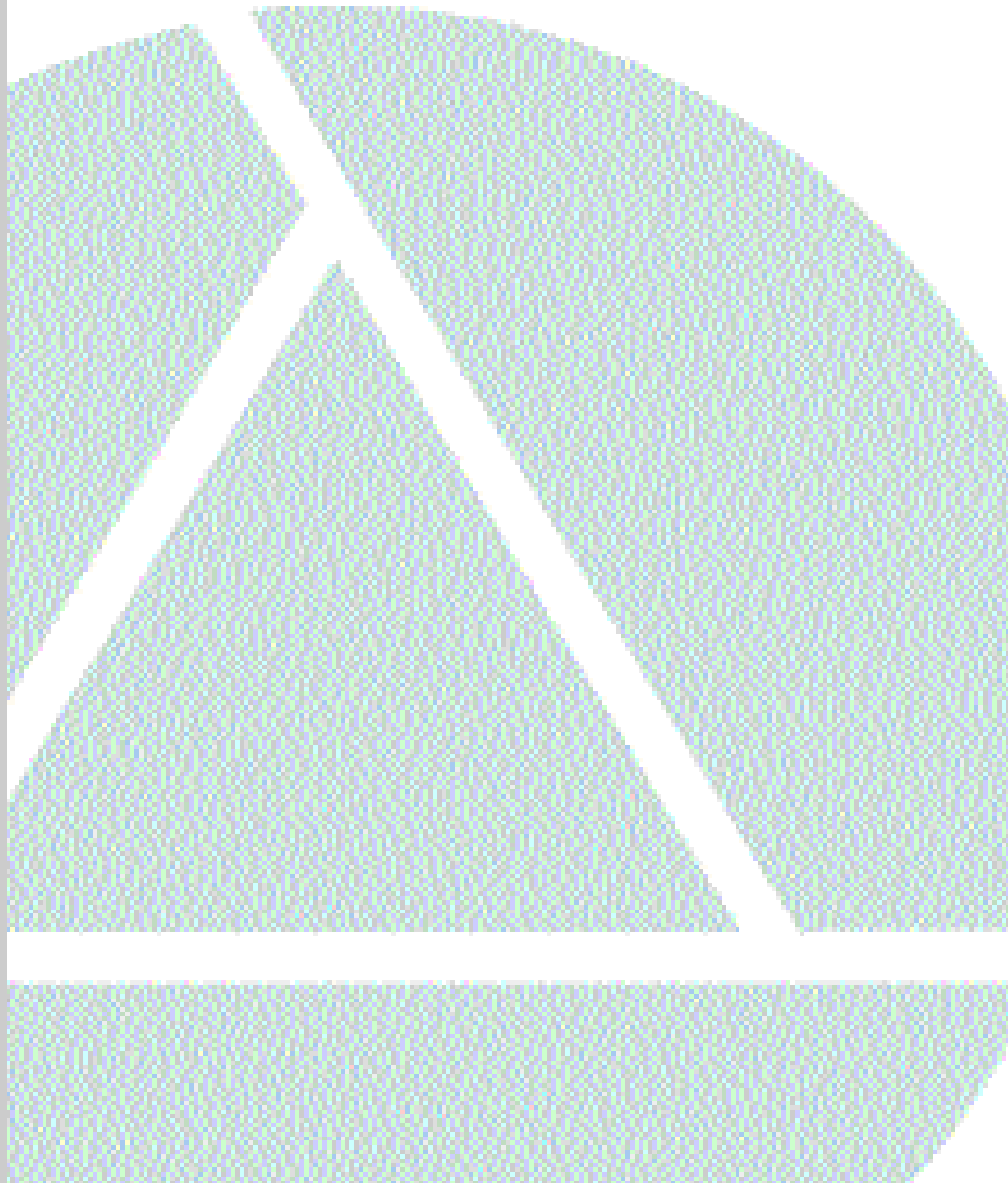


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auditor general's comments



auditor general's comments



A framework of financial information

As the Auditor General, I am often asked questions about the state of the government's finances. Both the citizens of British Columbia and their elected representatives want to know whether their government's finances are getting stronger or weaker, which revenues or expenses are increasing or decreasing, and how the province compares in these respects to other jurisdictions.

Recently, legislators directed the government to use generally accepted accounting principles to prepare its annual summary financial statements. The government has indicated it will do so no later than April 2004. By that date I expect the government's reporting entity to include British Columbia's schools, universities, colleges and hospitals (the SUCH sector). Until this happens the government's summary financial statements are incomplete. Even when they are complete, these statements alone will not provide all of the information required for monitoring the government's finances. Within these statements, however, there are various schedules, notes and supplementary information that when adjusted, reconciled and then put together can provide a complete and understandable picture of the government's finances.

In this report, I do just that. Using the information provided by the government, I have developed a framework of financial information that can be used to monitor the government's finances. The framework, which includes the SUCH sector, covers the five years ending March 31, 2001. I have not put together information for the years prior to 1997 because some necessary information is unavailable. Exhibit 1.1 summarizes this financial framework; it is presented in more detail on pages 32 and 33.

As the government adopts generally accepted accounting principles for its financial planning and reporting, I ask it to consider the framework set out in this report for its own use in informing legislators and all of the province's citizens on the state of the government's finances.

Exhibit 1.1

Financial Information Framework, 1997 to 2001

This financial information framework is built around the activities of the government's general programs and enterprises

Revenue and Expense					
For the Year Ended March 31					
(Amounts in \$ Millions)					
	1997	1998	1999	2000	2001
General programs					
Revenue	23,165	23,596	23,564	25,181	27,988
Expense	24,477	25,557	26,029	26,447	28,117
	(1,312)	(1,961)	(2,465)	(1,266)	(129)
Enterprises					
Revenue	7,884	8,284	9,434	10,380	14,496
Expense	6,809	6,958	7,914	9,085	12,771
	1,075	1,326	1,520	1,295	1,725
Annual surplus/(deficit)	(237)	(635)	(945)	29	1,596
Assets and Liabilities					
As At March 31					
(Amounts in \$ Millions)					
	1997	1998	1999	2000	2001
General programs					
Financial assets	6,419	7,205	7,419	9,580	9,550
Liabilities	28,651	29,737	30,983	33,801	33,701
	(22,232)	(22,532)	(23,564)	(24,221)	(24,151)
Enterprises					
Assets	17,760	18,439	19,299	18,814	19,387
Liabilities	14,819	15,677	16,414	16,069	16,386
	2,941	2,762	2,885	2,745	3,001
Net liabilities	(19,291)	(19,770)	(20,679)	(21,476)	(21,150)
General infrastructure assets	18,248	18,236	18,415	19,241	20,511
Accumulated deficit	(1,043)	(1,534)	(2,264)	(2,235)	(639)
Gross domestic product	109,049	114,601	115,604	120,608	127,564

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Statistics Canada for GDP

Recommendation

That the government implement generally accepted accounting principles as soon as possible.

Key measures and indicators

In 1997, the Canadian Institute of Chartered Accountants identified several financial and economic measures and indicators that it said should be used to monitor the state of a government's finances. It expressed these measures and indicators in terms of three concepts: sustainability, flexibility and vulnerability.

Sustainability—the ability of a government to meet its existing program commitments and creditor requirements without increasing its net liabilities.

Flexibility—the degree to which a government can increase financial resources to respond to rising commitments either by expanding its revenues or by increasing its net liabilities.

Vulnerability—the degree to which a government becomes dependent on, and thus vulnerable to, sources of funding outside of its control or influence.

Three measures provide particularly useful insight into a government's finances. Those measures are a government's annual surplus or deficit, its net liabilities, and the province's gross domestic product.

The annual surplus or deficit shows the extent to which the costs incurred by a government are more or less than what it raises in revenues in one fiscal year.

Net liabilities is the difference between a government's total liabilities and its financial assets. Net liabilities is the amount current and past generations of British Columbia citizens are leaving to future generations of citizens to pay or finance.

A province's gross domestic product (GDP) is a measure of the total value of all the goods and services produced in the province in one year. The GDP represents the size of the provincial economy. A government manages its revenue-raising and spending practices in the context of the provincial economy.

During three of the past five years, the annual costs of government were more than its revenues—see Exhibit 1.2.

During the past five years, the government’s net liabilities increased \$1.8 billion, from \$19.3 billion to \$21.1 billion (up 9.3%). Accordingly, the amount future generations of British Columbia citizens are being asked to pay or finance has increased—see Exhibit 1.3.

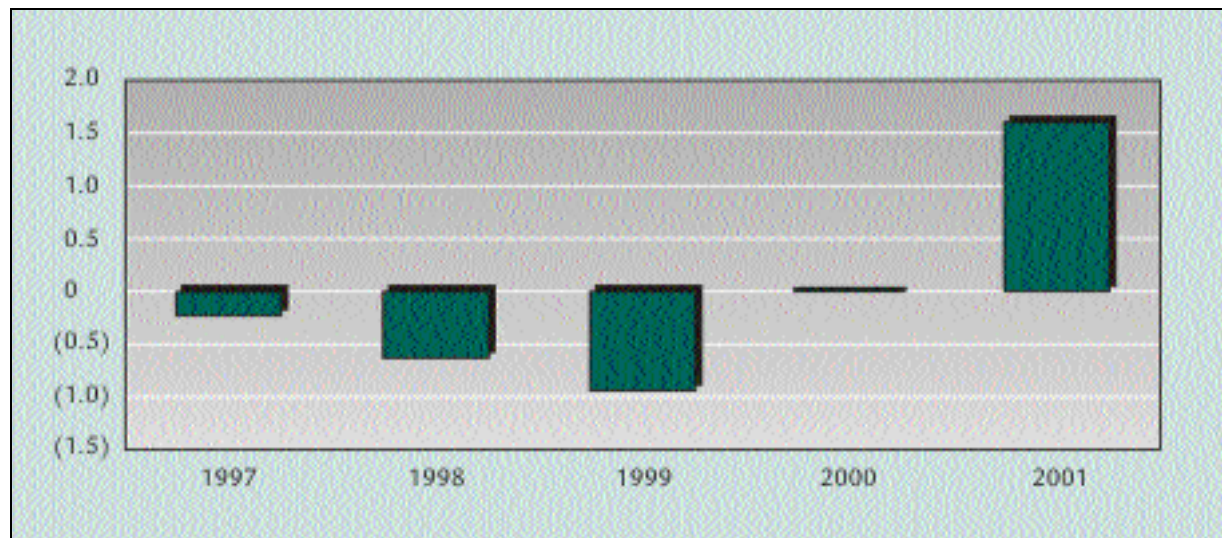
In the same five-year period, the province’s GDP increased \$18.6 billion, from \$109.0 billion to \$127.6 billion (up 17.1%)—see Exhibit 1.4.

The ratio of a government’s net liabilities to a province’s GDP provides a key indicator of the sustainability of government’s finances. This indicator shows the extent to which the province’s economy will need to support a government’s past revenue raising and spending practices.

Exhibit 1.2

Annual Surplus/(Deficit), 1997 to 2001

The annual surplus/(deficit) (\$ Billions)

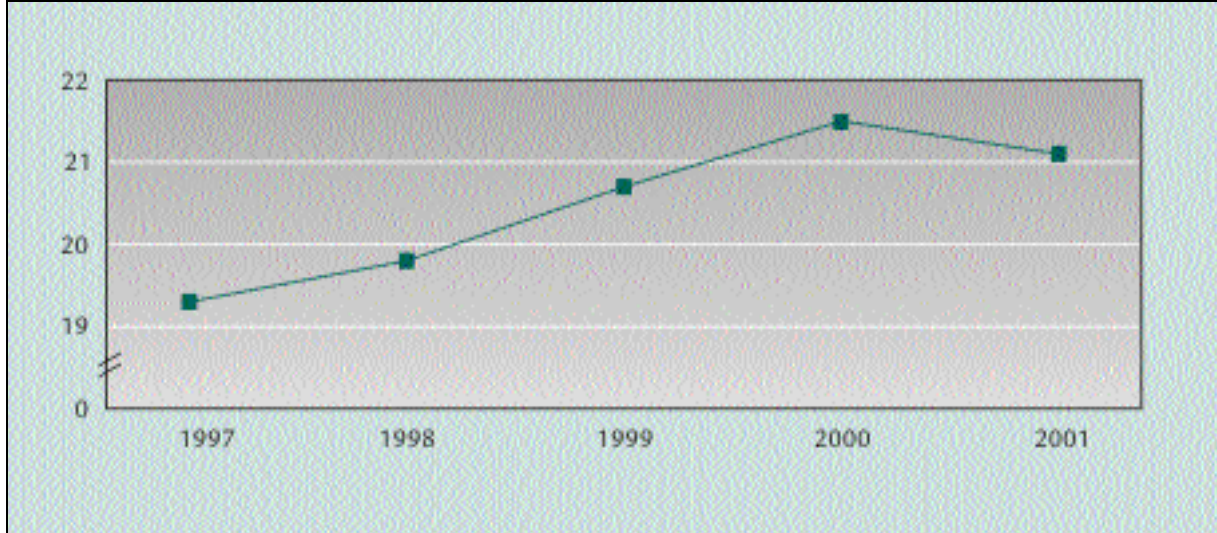


Source: Office of the Auditor General of British Columbia

Exhibit 1.3

Net Liabilities, 1997 to 2001

Net liabilities represents the financial burden that current and past citizens transfer to the future taxpayer (\$ Billions)

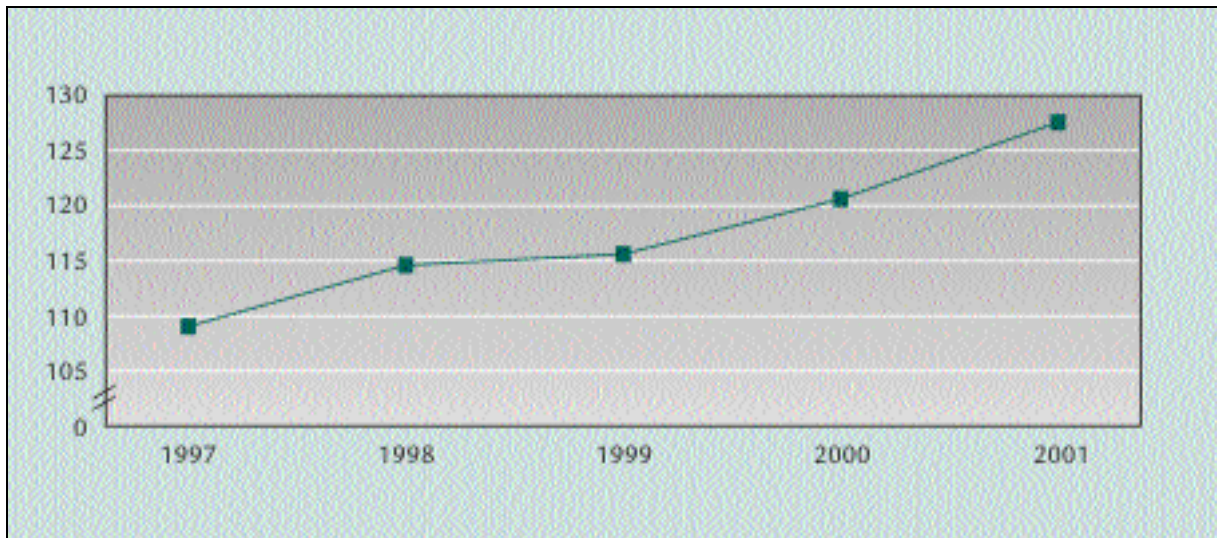


Source: Office of the Auditor General of British Columbia

Exhibit 1.4

British Columbia's Gross Domestic Product (GDP), 1997 to 2001

The GDP represents the size of the provincial economy (\$ Billions)



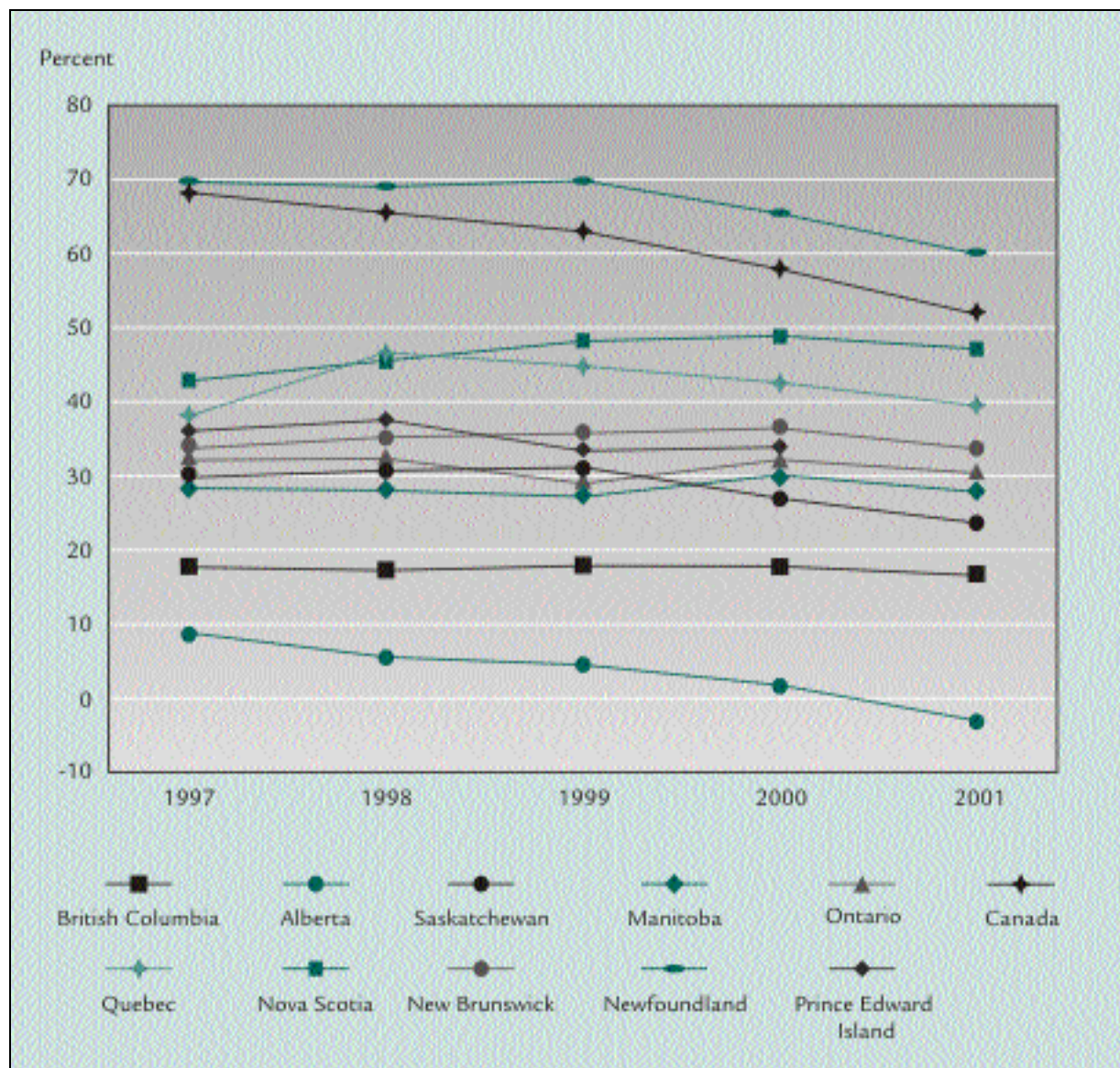
Source: Statistics Canada

During the past five years, the government's net liabilities to the province's GDP has decreased slightly, from 17.7% to 16.6%. This tells us that the province's economy has grown more than the government's net liabilities.

Exhibit 1.5

Net Liabilities to Gross Domestic Product (GDP) for Canada and the Provinces, 1997 to 2001

The extent to which the economy is able to sustain the demands placed on it by the government



Source: Office of the Auditor General of British Columbia

Comparing British Columbia to Other Provinces

People also ask me how the state of finances of British Columbia compares to other provinces. Interprovincial comparisons are difficult because government financial reporting practices are still not consistent.

However, most governments do report their net liabilities and their province's gross domestic product. Some governments refer to net liabilities as their net debt or accumulated deficit.

Exhibit 1.5 shows the net liabilities to GDP ratio for Canada and the provinces. Among Canada and the provinces, the Province of British Columbia's economy as represented by its GDP is the second most able to support its government's past revenue-raising and spending practices.

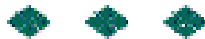
In the future, I plan to continue reporting on the state of the government's finances. Intergovernmental comparisons of other important indicators should become more readily available as government financial reporting practices continue to strengthen.

In the next section of the report, I set out trends in important financial and economic measures and indicators for the government of the Province of British Columbia. The financial measures are based on the financial information framework set out in Exhibit 1.1.

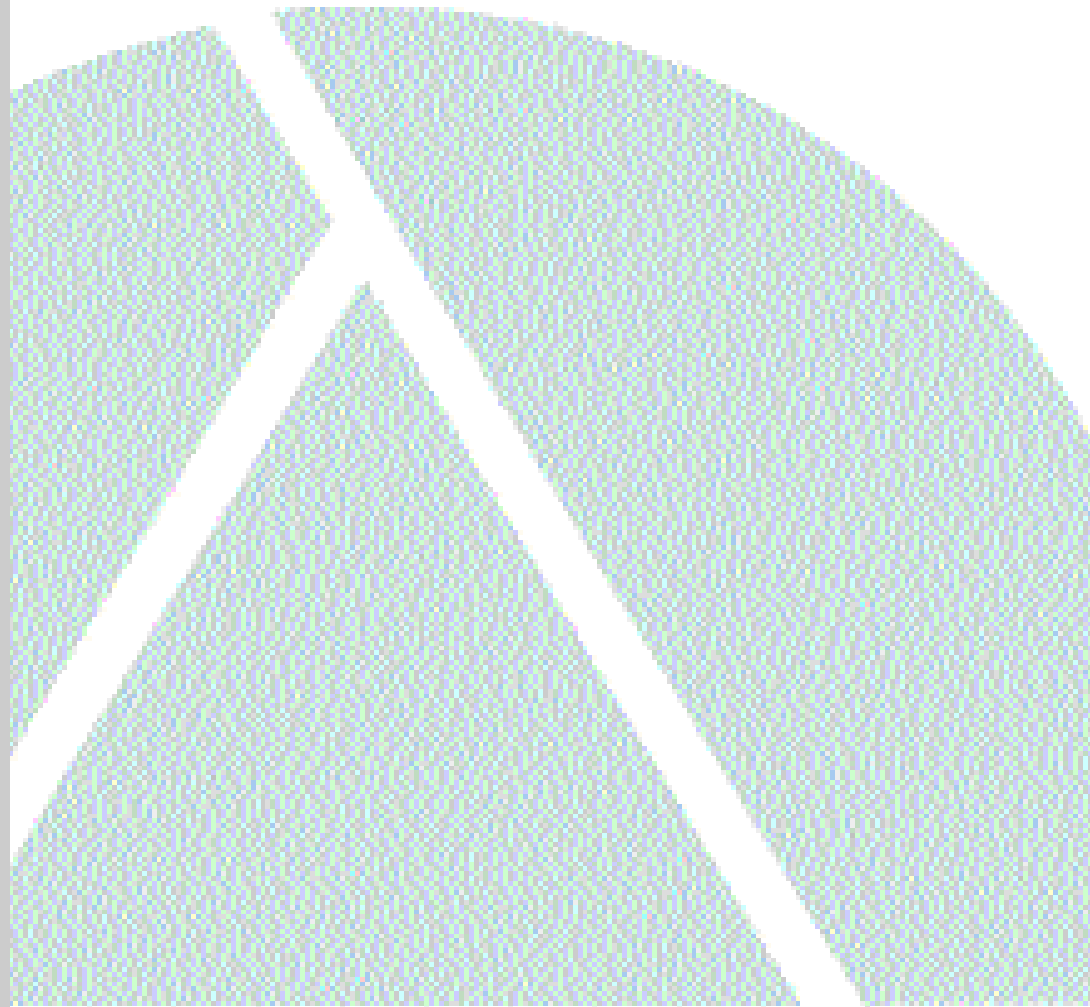
Recommendation

That the government use the indicators of financial condition identified by the Canadian Institute of Chartered Accountants, and other important financial and economic measures, to inform the legislators and citizens of British Columbia of the state of the government's finances.

This report sets out the revenues, expenses, assets and liabilities of the government in more detail on pages 32 and 33. Appendix A contains a copy of the government's summary financial statements for the year ended March 31, 2001.



trends in
financial measures
and economic indicators



trends in financial measures and economic indicators

The summary financial statements are the public's main source for information on the province's finances. However, these financial statements are currently incomplete because they do not include schools, universities, colleges and hospitals (the SUCH sector). In addition, the balance sheet and statement of operations do not include details of all the assets, liabilities, revenues and expenses of government's enterprises.

To understand the state of the government's finances, I found it helpful to first establish a basic framework that provides complete financial information on all aspects of the government's operations. I structured this financial framework around government's general programs and its enterprises, and summarized in it for the past five years the revenues, expenses, assets and liabilities of every organization that makes up the government reporting entity. This framework's reporting entity includes the SUCH sector. The result is a five-year compilation of complete financial information that is prepared on a comparable basis. This framework of financial information is shown in more detail on pages 32 and 33. For my purposes here, I have used information from this financial framework in charting the trends of government's key financial measures and indicators.

The government's enterprises include all business-type entities that operate profitably and that generate substantially all their revenues from sources outside the government. In the 2000/01 fiscal year, the combined revenues, expenses, assets and liabilities of government enterprises amounted to \$14.5 billion, \$12.8 billion, \$19.4 billion and \$16.4 billion, respectively.

All other activities of the government are in general programs.

Revenue Trends

Exhibit 2.1 shows the government's revenue sources from general programs and enterprises. The government's total annual revenue has risen from \$31.1 billion to \$42.5 billion in the past five years, an increase of 37%. Of that \$11.4 billion increase in revenue, \$0.9 billion was from taxes. Revenue earned by enterprises accounted for \$6.6 billion of that increase.

Exhibit 2.1

Government Revenue, 1997 to 2001

Government revenue by main source (\$ Billions)

	1997	1998	1999	2000	2001
General programs					
Taxation	13.5	13.5	13.6	13.8	14.4
Natural resources	2.7	2.7	2.0	2.8	4.2
Federal transfer	2.2	2.1	2.4	2.9	3.0
Other	4.8	5.3	5.6	5.7	6.4
	23.2	23.6	23.6	25.2	28.0
Enterprises	7.9	8.3	9.4	10.4	14.5
Total revenue	31.1	31.9	33.0	35.6	42.5

Source: Office of the Auditor General of British Columbia

Exhibit 2.1 shows the total revenue of the province earned from taxation, natural resources, the operations of commercial enterprises, federal transfers and other sources. Per capita revenue for each of those sources are shown in Exhibit 2.2. Taxes and revenue generated from businesses operated by enterprises were the two most significant sources of revenue for the government of British Columbia in 2001, each contributing about one-third of the total revenue.

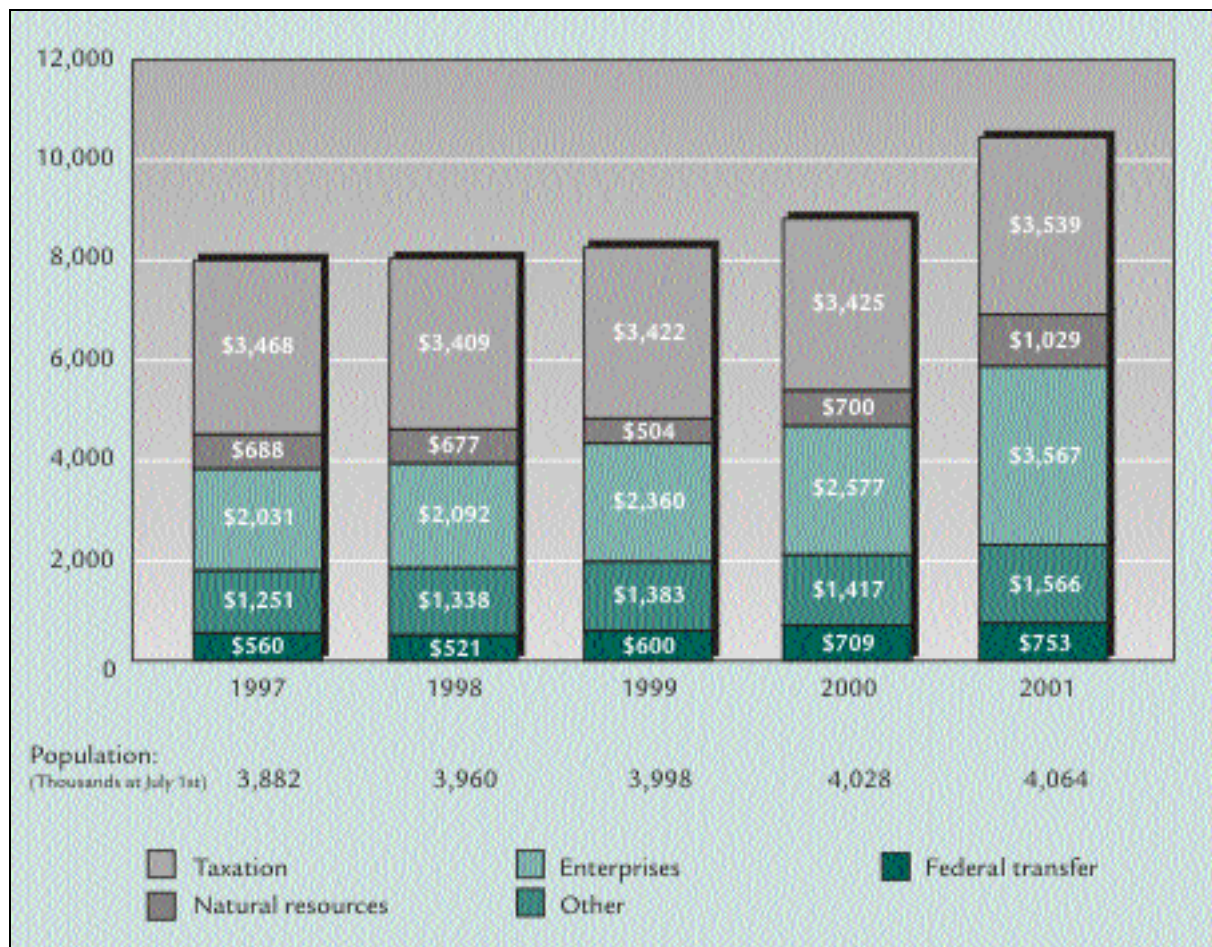
Over the last five years, taxation revenue increased by 7%, from \$13.5 billion in 1997 to \$14.4 billion in 2001, while revenue earned by the commercial enterprises increased by 84%, from \$7.9 billion in 1997 to \$14.5 billion in 2001.

The government collects taxes from many sources, the most important being those relating to personal and corporate income, property and sales. Average taxation revenue generated by each resident of British Columbia increased from \$3,468 in 1997 to \$3,539 in 2001. Compared with all other taxes, personal taxes were the most significant source, having accounted annually in the five-year period, 1997–2001, for between 39 and 42% of the total taxes collected. As a result of the personal tax reductions announced by the new government on June 6, 2001, personal tax revenue in 2002 is forecast to decline by about \$1.1 billion, or 18% of the amount recorded in 2001. Expressed in other terms, this means that the average personal taxation revenue generated by each resident of British Columbia will be lowered by approximately \$250 in 2002.

Exhibit 2.2

Per Capita Revenue, 1997 to 2001

Per capita revenue by main source over the past five years



Source: Office of the Auditor General of British Columbia; Statistics Canada

Besides taxes, the government's other main source of revenue comes from businesses operated by its commercial enterprises such as British Columbia Hydro and Power Authority (BC Hydro), the Insurance Corporation of British Columbia, the British Columbia Liquor Distribution Branch, and the British Columbia Lottery Corporation. Together these enterprises generated \$14.5 billion of revenue for the Province in 2001 — a significant increase of 84% since 1997 and a 40% increase over the \$10.4 billion recorded in 2000. The increase was largely due to higher electricity trade with customers outside the province through BC Hydro, and to higher market prices for energy.

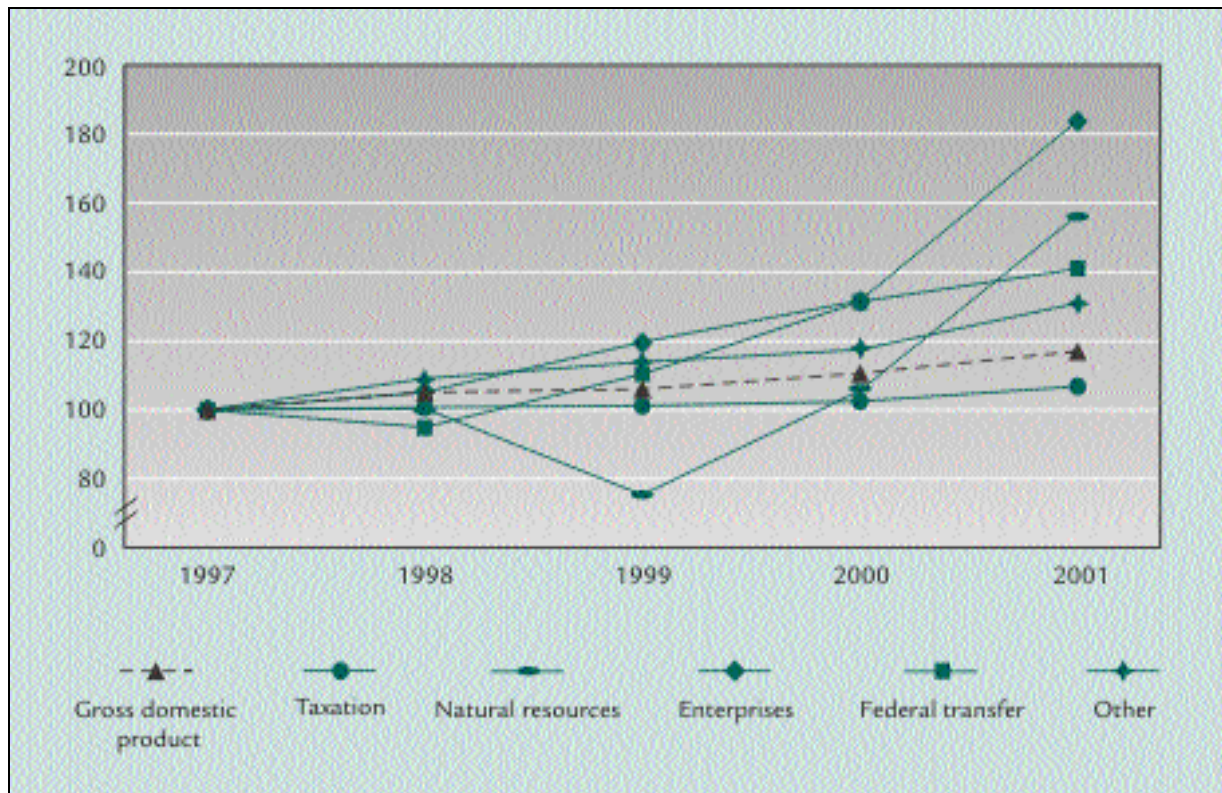
Exhibit 2.3 shows the rate of change in revenue over the last five years by the main sources. The base year in this exhibit is 1997. Revenue for each main source in the four years that follow has been shown as a percentage of that for 1997.

Generally, the rate of change in revenue for most revenue sources shows a gradual increase, as does the GDP's. The exceptions are natural resource revenue and revenue generated from businesses operated by commercial enterprises. Natural resource revenue declined sharply in 1999 because of stumpage rate reductions in the forest industry. It then increased significantly in 2000 and 2001 because of higher oil and natural gas prices that resulted in higher royalty sales of Crown land drilling rights in those years. Also, because of the higher energy prices, revenue generated by BC Hydro increased significantly in 2001 over the previous year.

Exhibit 2.3

Change in Revenue, 1997 to 2001

Rate of change in revenue by main source, compared to the Gross Domestic Product (GDP) (1997 = 100)



Source: Office of the Auditor General of British Columbia; Statistics Canada

Expense Trends

Exhibit 2.4 shows the annual expenses incurred by government, for general programs and enterprises, from 1997 to 2001.

Total government expenses increased from \$31.3 billion in 1997 to \$40.9 billion in 2001, an increase of 31%. In the 2000/2001 fiscal year, health, education and social services accounted in total for 50% of the total expense of the Province.

The largest increase in expense over the five-year period occurred in government enterprises from \$6.8 billion in 1997 to \$12.8 billion in 2001, a \$6.0 billion or 88% jump. The increase in 2001 alone from the previous year was 41%, an amount largely attributable to BC Hydro's operations. The cost of electricity purchased by BC Hydro for resale made up a significant part of this increased expense in the government's commercial enterprises. BC Hydro's costs to purchase energy in the electricity trade market have substantially risen over the last year as electricity and gas prices have risen. BC Hydro also had to increase the volume of its purchases to meet increases in demand.

Exhibit 2.4

Government Expense, 1997 to 2001

Government expense by main component (\$ Billions)

	1997	1998	1999	2000	2001
General programs					
Health	7.5	7.8	8.1	8.8	9.4
Education	6.5	6.5	6.9	7.2	7.7
Social services	3.1	3.2	3.2	3.1	3.3
Other*	3.9	4.6	4.6	4.3	4.6
General government, debt servicing	3.5	3.5	3.2	3.0	3.1
	24.5	25.6	26.0	26.4	28.1
Enterprises	6.8	6.9	7.9	9.1	12.8
Total expense	31.3	32.5	33.9	35.5	40.9

*In this table transportation, protection and economic development functions are grouped as "other."

Source: Office of the Auditor General of British Columbia

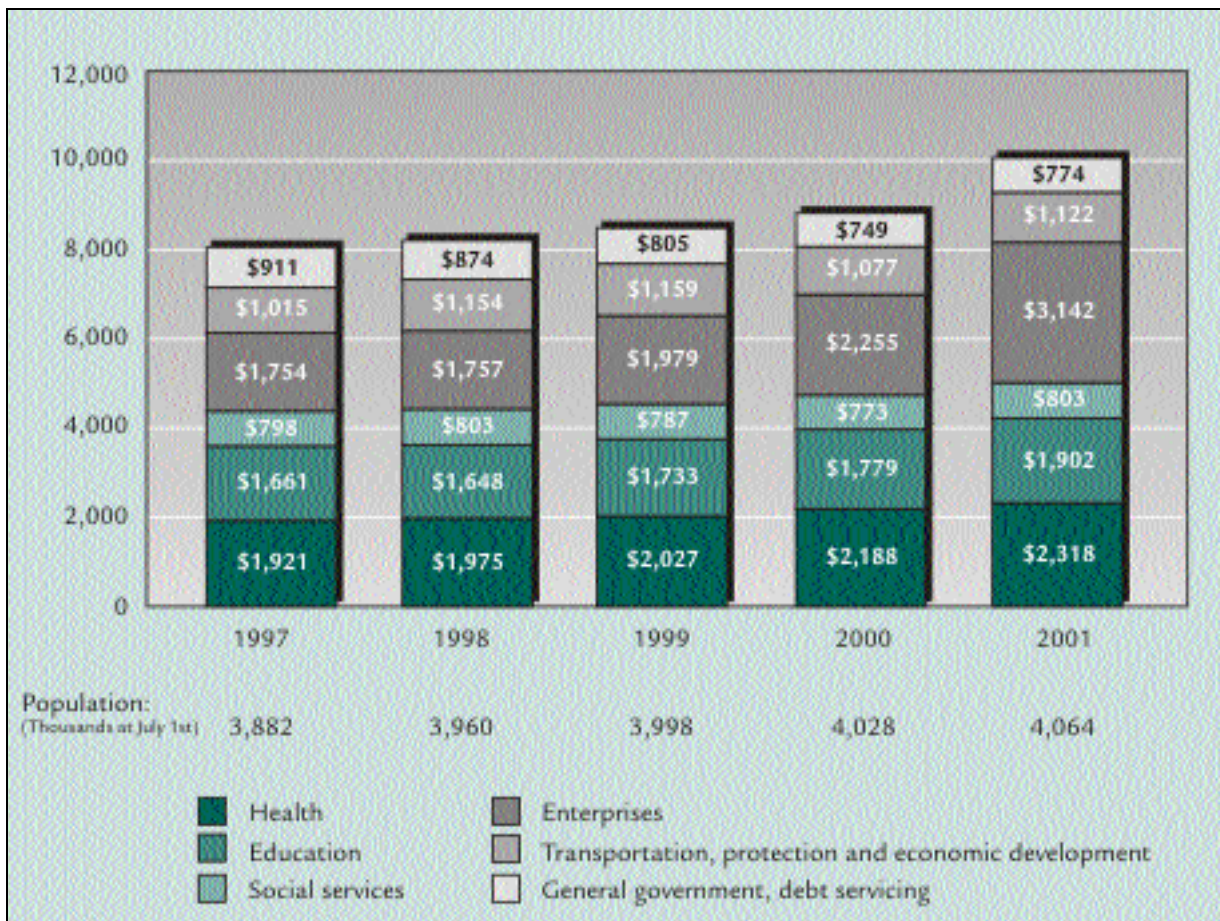
Exhibit 2.5 shows the government's per capita expense for the last five years, by expense category.

Exhibit 2.6 shows the rate of change in per capita expenses over the last five years for health, education, social services, and enterprises. To show the change over the past five years, the per capita expense in each category has been indexed to that expense in the year 1997. The expense is in actual dollars and has not been adjusted for inflation. However, the British Columbia Consumer Price Index (CPI) is plotted to show the general increase in prices in the province, also indexed to 1997, for comparison.

Exhibit 2.5

Per Capita Expense, 1997 to 2001

Per capita expense by main component over the past five years



Source: Office of the Auditor General of British Columbia; Statistics Canada

The exhibit shows that while health and education spending generally grew at an increasing rate between 1997 and 2000, social services spending declined for the same period. Health and education spending continued to rise in 2001, as did social services spending, the latter at a rate close to the rate of increase in the CPI for that year.

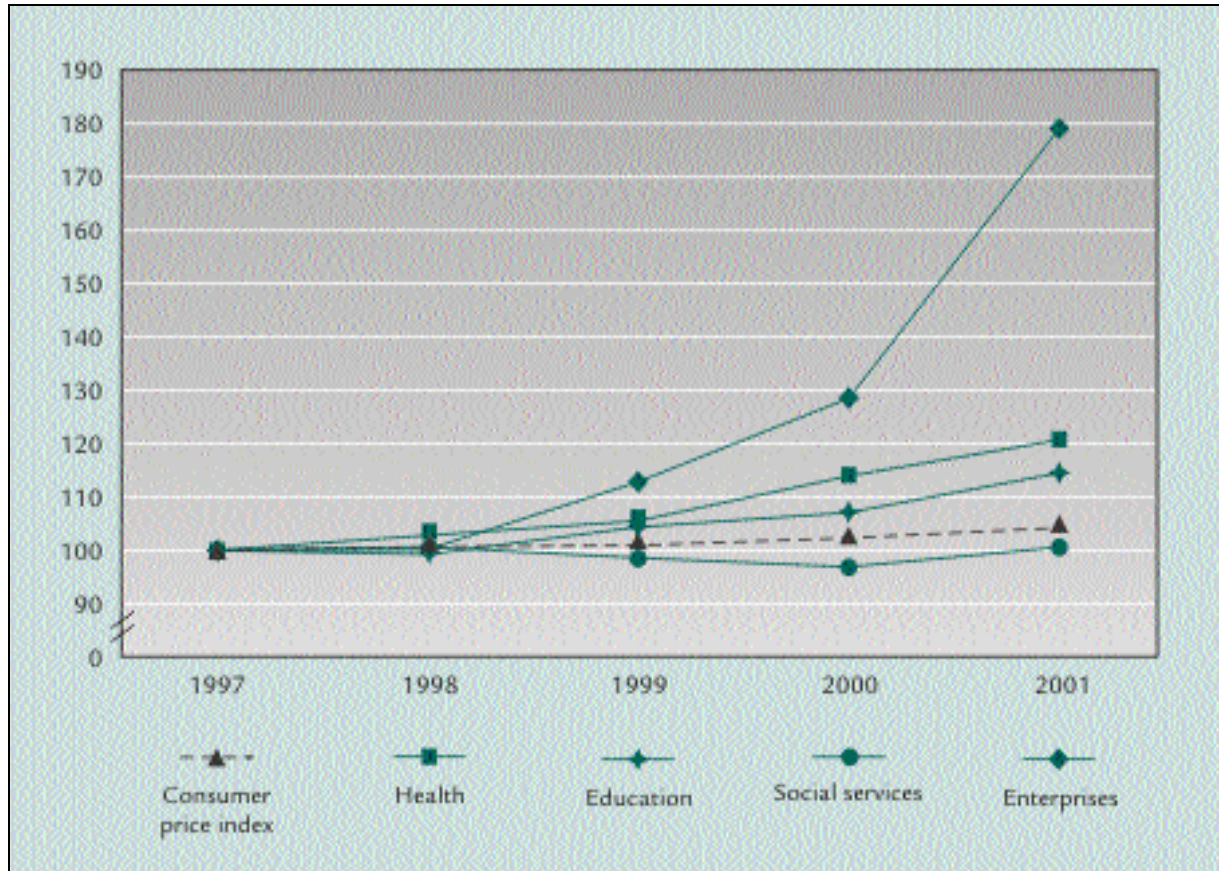
Asset Trends

Government assets are grouped according to their use and are considered to be either financial or physical. Financial assets are cash, investments, loans and other types of receivables. They also include inventories and amounts due from other governments. Physical capital assets are the tangible assets that the government has paid for or traded assets for. These assets are recorded in the government's financial statements at their

Exhibit 2.6

Change in Per Capita Expense, 1997 to 2001

Rate of change in per capita expense for health, education, social services, and enterprises compared to the Consumer Price Index (1997 = 100)



Source: Office of the Auditor General of British Columbia; Statistics Canada

net book value (cost less depreciation). They exclude Crown land, forests and other natural resources that belong to the Crown.

Assets are also characterized as “revenue-generating” or “infrastructure.” All assets of enterprises—financial and capital—are revenue-generating assets. Physical capital assets used in the government’s general programs do not generate direct revenue. They are the infrastructure needed to serve the public. Those used in government enterprises, however—such as railways, trains, hydro-electric dams, and transmission lines—do generate revenue. The distinction between revenue-generating capital assets and infrastructure assets is important because generally a government does not pay off its debt by selling the infrastructure needed to serve citizens.

Exhibit 2.7 presents an overview of the two categories of government assets. It also shows the value of all capital assets owned by the government.

From 1997 to 2001, total assets of government increased from \$42.4 billion to \$49.5 billion, a growth of 16.7%. Increases in capital assets accounted for approximately 30% of this change.

Because of British Columbia’s size and geography, the need for capital infrastructure within the province is substantial. In the last five years, the net book value of infrastructure assets of the government (such as hospitals, other health care facilities, schools, post-secondary institutions, roads, ferries, buses and rapid transit) has increased from \$18.2 billion to \$20.5 billion, a 12.6% increase.

In the same five-year period, the value of revenue-generating capital assets of the government enterprises (such as those used in power generation, transmission and distribution) increased by 9.0% from \$17.8 billion to \$19.4 billion.

The total value of physical capital assets owned by the government, used in both its commercial activities and general programs, has increased from \$29.2 billion to \$31.3 billion, or 7.2%.

Exhibit 2.8 shows the percentage change in the net book value of health, education, transportation and energy capital assets from 1997 to 2001. Capital spending increased each year, except 1998, to maintain and replace assets and to meet the needs of the province’s expanding population. In 1998, the government slowed capital spending—in particular that on transportation—to examine its capital investment policy and to look for alternative ways to meet the province’s infrastructure needs.

Exhibit 2.7

Assets, 1997 to 2001

Financial, revenue-generating, infrastructure and total capital assets of the government (\$ Billions)

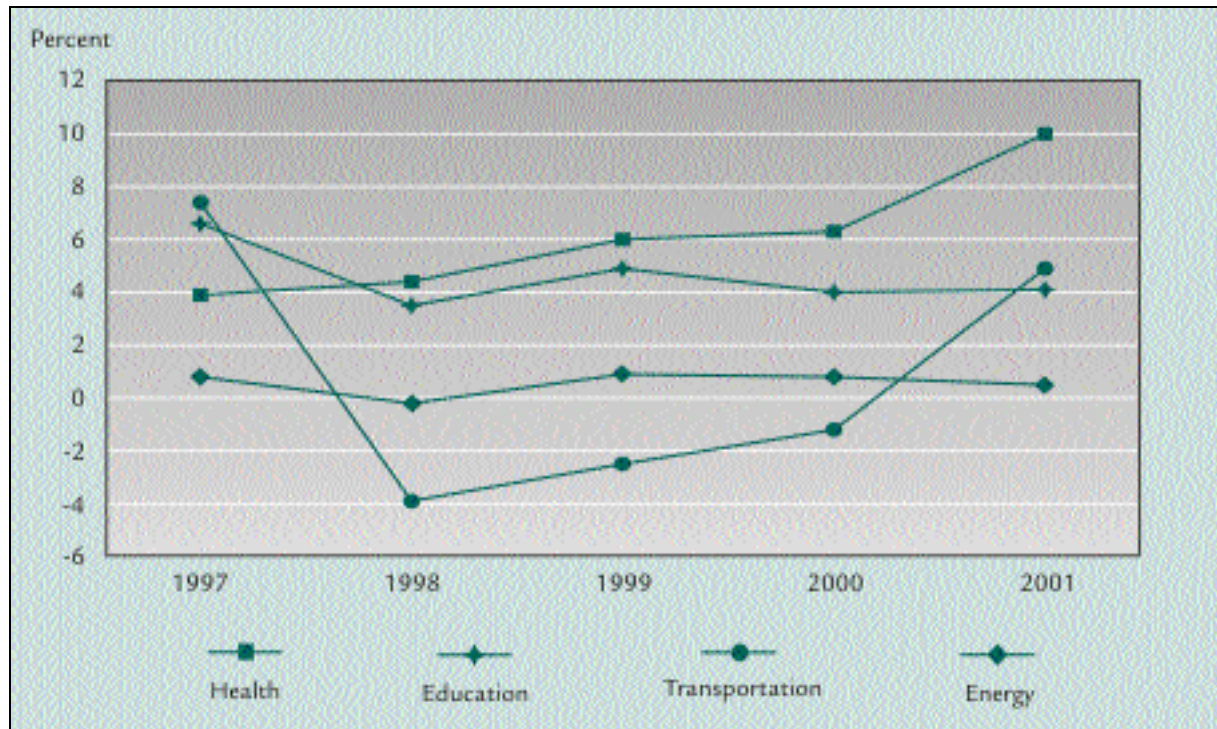
	1997	1998	1999	2000	2001
General programs					
Financial assets	6.4	7.2	7.4	9.6	9.6
Enterprises					
Revenue-generating assets	17.8	18.5	19.3	18.8	19.4
	24.2	25.7	26.7	28.4	29.0
Infrastructure assets	18.2	18.2	18.4	19.2	20.5
	42.4	43.9	45.1	47.6	49.5
Total physical capital assets	29.2	29.3	29.7	30.1	31.3

Source: Office of the Auditor General of British Columbia

Exhibit 2.8

Change in Physical Capital Assets, 1997 to 2001

Annual percentage change in the net book value of capital assets for health, education, transportation and energy



Source: Office of the Auditor General of British Columbia

Government borrows for different reasons: it may do so to finance its operating shortfalls, to build up its stock of capital assets, for investment or lending, or simply to ensure funds are there when it needs them. Exhibit 2.9 shows the increase in book value of the government’s infrastructure and revenue-generating capital assets for each of the years 1997 to 2001, compared to the change in debt each year for general programs and for enterprises. In 1997, the government drew down funds it had borrowed in the previous year to finance its annual deficit and capital spending. Between 1998 and 2000, the government increased its borrowing and warehoused funds for use at a later date. In 2001, the government financed its increase in capital assets of \$1.2 billion from its annual surplus and by cashing its temporary investments.

Liability Trends

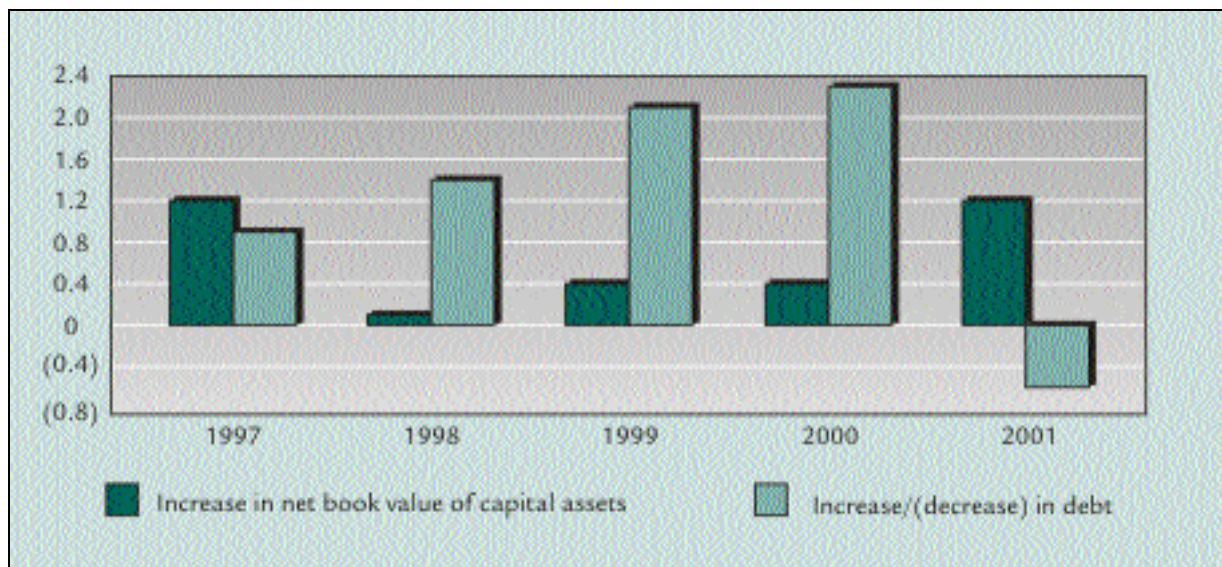
Government is liable for its obligations to individuals, private firms and other governments. Public debt—amounts borrowed by the government—makes up a very large part of this obligation.

Exhibit 2.10 shows the government’s debt and other obligations in the last five years, by general programs and enterprises.

Exhibit 2.9

Comparing Changes in Capital Assets and Public Debt, 1997 to 2001

Increase in net book value of capital assets compared to change in debt (\$ Billions)



Source: Office of the Auditor General of British Columbia

The liabilities of government enterprises are expected to be paid through their commercial activities. The general program obligations, however, have to be met by financial assets available to government general programs, which include the net assets of enterprises. Any shortage in the equation—referred to as “net liabilities”—will have to be borne by future taxpayers.

Exhibit 2.11 shows the future taxpayers’ net liabilities at the end of each of the years 1997 to 2001. Over the five years, net liabilities increased from \$19.3 billion to \$21.1 billion, an overall increase of 9.3%. In 2001, the increasing trend in net liabilities took a downward (positive) turn—a change that is not expected to be sustained over the short term.

Exhibit 2.10

Liabilities, 1997 to 2001

(\$ Billions)

	1997	1998	1999	2000	2001
General programs					
Debt	21.1	22.1	23.8	26.5	26.3
Other obligations	7.6	7.6	7.2	7.3	7.4
	28.7	29.7	31.0	33.8	33.7
Enterprises					
Debt	8.0	8.4	8.8	8.4	8.0
Other obligations	6.8	7.3	7.6	7.6	8.4
	14.8	15.7	16.4	16.0	16.4
Total liabilities	43.5	45.4	47.4	49.8	50.1

Source: Office of the Auditor General of British Columbia

Exhibit 2.11

Net Liabilities, 1997 to 2001

(\$ Billions)

	1997	1998	1999	2000	2001
Government’s liabilities	43.5	45.4	47.4	49.8	50.1
Less: Financial assets (including assets of enterprises)	24.2	25.6	26.7	28.3	29.0
Net liabilities	19.3	19.8	20.7	21.5	21.1

Source: Office of the Auditor General of British Columbia

Indicators of Financial Condition

Can the government continue to provide its programs? Is there room for new or different programs? How dependent is the government on lenders and other governments? These are the questions that can be answered if we examine the indicators of financial condition.

In 1997, a research group of the Canadian Institute of Chartered Accountants (CICA) developed the indicators of the government financial condition and published them in a report titled “Indicators of Government Financial Condition.” Senior governments and market analysts in Canada have started to use these indicators to monitor the financial condition of the federal and provincial governments with respect to the following concepts:

- **Sustainability** – the degree to which a government can maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy;
- **Flexibility** – the degree to which a government can increase its financial resources to respond to rising commitments, by either expanding its revenues or increasing its debt burden; and
- **Vulnerability** – the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence, both domestic and international.

The CICA recommends 10 indicators of government financial condition, seven of which are relevant to provincial governments. They are summarized in Exhibit 2.12.

Sustainability Indicators

The two sustainability indicators measure the size of the annual surplus/deficit and the net liabilities in relation to the size of the provincial economy. A stable net liabilities to GDP ratio indicates that the rate of growth in the economy is similar to the rate of growth of the province’s net liabilities. An increasing ratio would indicate that the government’s current fiscal policies are increasing the burden on the provincial economy and on future taxpayers. A declining ratio would signal the opposite.

Exhibit 2.13 shows the five-year trend of net liabilities to GDP for British Columbia. The comparison shows a relatively stable trend, which generally means that the overall burden on taxpayers as a result of government’s fiscal policies on

Exhibit 2.12

Indicators of Financial Condition

This report presents a five-year trend for each of the CICA's indicators of government financial condition

Sustainability indicators:

1. Net liabilities to gross domestic product
2. Change in net liabilities to gross domestic product

Flexibility indicators:

3. Public debt charges to revenue
4. Changes in physical capital stock
5. Own-source revenue to GDP

Vulnerability indicators:

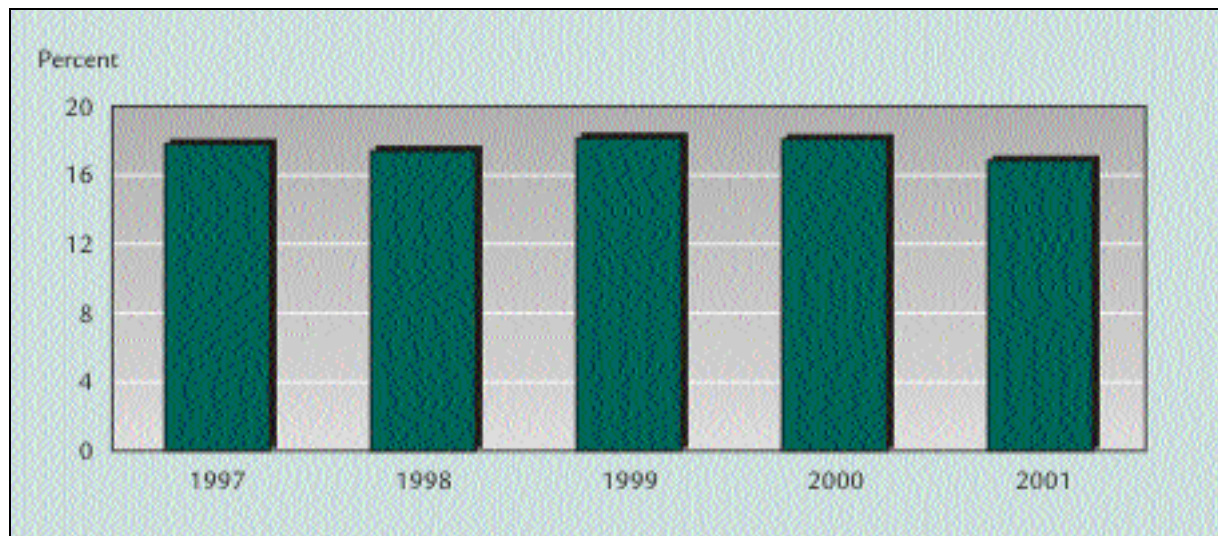
6. Government-to-government transfers to own-source revenue
7. Foreign currency debt to total government debt

Source: Canadian Institute of Chartered Accountants

Exhibit 2.13

Net Liabilities to Gross Domestic Product (GDP), 1997 to 2001

Net liabilities as a percentage of GDP in British Columbia



Source: Office of the Auditor General of British Columbia; Statistics Canada

spending and revenue-raising practices has remained relatively constant in the last five years.

Exhibit 2.14 shows the change in net liabilities to GDP ratio in British Columbia for each of the past five years. There is no “correct” or “optimal” ratio of net liabilities to GDP that a government should aim to achieve. The trend should be examined in conjunction with other financial indicators of the government’s finances. The fluctuation in this ratio over the past five years has been less than 2%.

Flexibility Indicators

The three indicators of government’s financial flexibility are:

- public debt charges to revenues;
- changes in physical capital stock; and
- own-source revenue to GDP.

The indicator of public debt charges to revenues, often referred to as the “interest bite,” shows how much of each dollar of a province’s total revenue is used to pay for servicing total public debt (cost of borrowing). It is normally measured in the form of cents per dollar of revenues. If an increasing portion of the revenues of a province were used by the government for this purpose, then less money would be left for services to taxpayers.

Exhibit 2.15 shows the five-year trend in public debt charges to revenues. The interest bite trend for British Columbia improved slightly between 1997 and 2001. We calculated the interest bite of the Province to be approximately 6.2 cents for the 2000/01 fiscal year (compared to 7.3 cents in 1999/2000). This improvement in the interest bite was due mainly to the substantial increase in 2000/01 revenues, offset by a small increase in the total cost of borrowing.

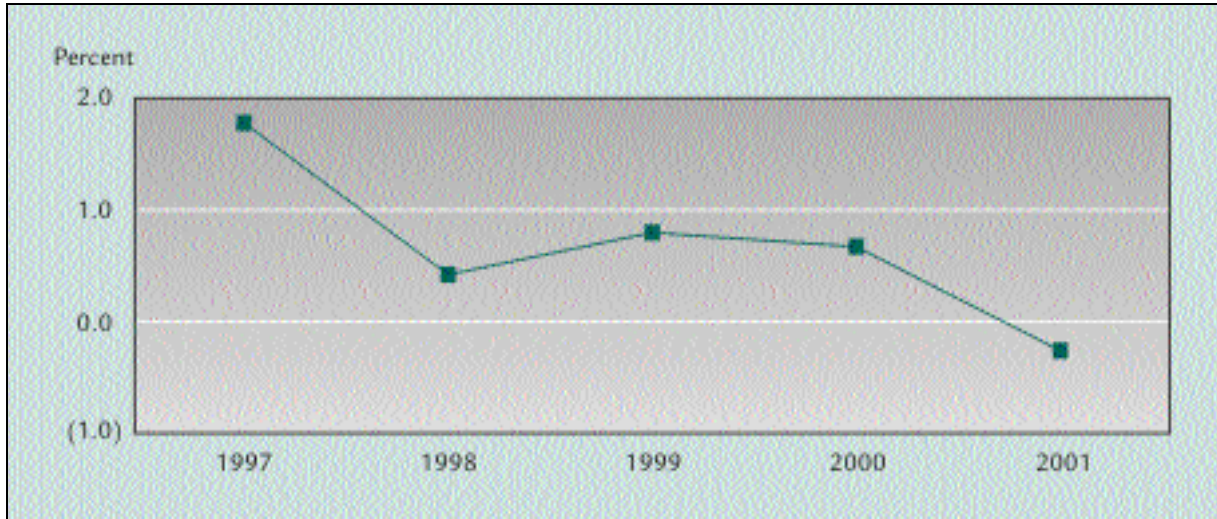
The trend of changes in physical capital stock indicates the net amount of spending on infrastructure and other capital items by government. It is measured as the percentage change in the net book value of physical assets (cost less accumulated depreciation).

Governments should put in place and maintain adequate infrastructure for serving its citizens. Any deferring of expenditures on maintenance can lead to the need for expensive corrections at a later date — and such strain on future resources reduces the flexibility of governments to provide other services.

Exhibit 2.14

Change in Net Liabilities to Gross Domestic Product (GDP), 1997 to 2001

Annual change in net liabilities expressed as a percentage of GDP in British Columbia

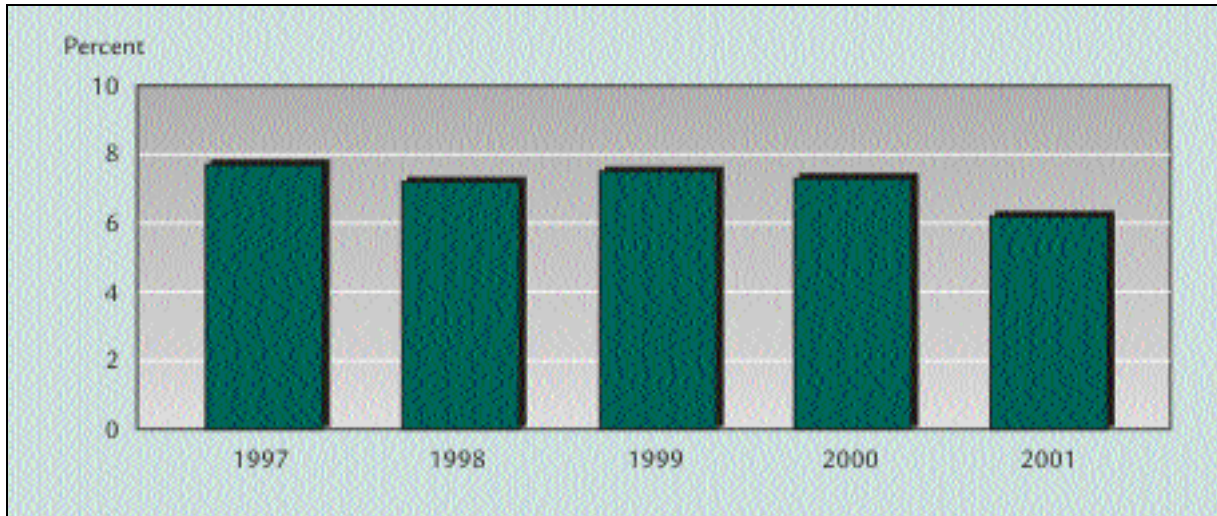


Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 2.15

Public Debt Charges to Revenues (the "Interest Bite"), 1997 to 2001

Debt interest expense as a percentage of total provincial revenue



Source: Office of the Auditor General of British Columbia

Exhibit 2.16 shows the annual percentage changes in physical capital stock of the provincial government from 1997 to 2001. As the graph indicates, the government's capital spending on infrastructure assets was constrained in 1998, and then increased annually from 1999 to 2001.

The ratio of own-source revenue to GDP represents the extent to which the government is taking income from its own economy in the form of taxation revenue and user fees. Typically, own-source revenue is all revenue other than federal transfers. This indicator measures the percentage of revenues that a government collects directly from the value of the provincial economy.

Exhibit 2.17 shows the ratio of own-source revenue to GDP for the five years 1997 to 2001. The government has raised its own-source revenue steadily over the last five years at a pace slightly faster than the growth of the province's economy.

Vulnerability Indicators

The two relevant indicators of government's financial vulnerability are:

- government-to-government transfers to own-source revenue; and
- foreign currency debt to total government debt.

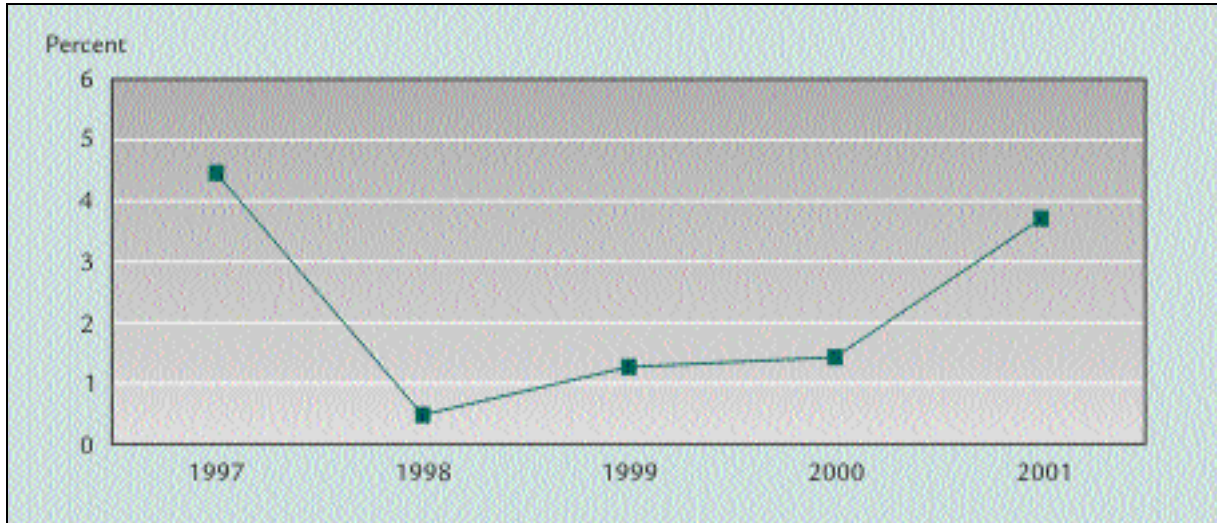
The idea behind this set of indicators is that funds obtained from federal or international sources (either from government transfers or borrowing) are not considered to be as controllable as revenue generated within a province. Own-source revenue is more controllable by a government through tax legislation, the changing of fees and licences, or the imposition of new fees and licences.

Provinces receive transfers from the federal government to support delivery of health, education, social services and other programs. Government-to-government transfers to own-source revenue compares federal government transfers to revenue raised through provincial taxation, fees, licences and earnings of a provincial government's commercial enterprises. Any increase in the ratio may denote a higher dependence of a province on the federal government as a funding source. Because provinces do not normally control federal decisions, an increase in their dependence will likely add to their financial vulnerability.

Exhibit 2.16

Changes in Physical Capital Stock, 1997 to 2001

Annual percentage change in the net book value of capital assets

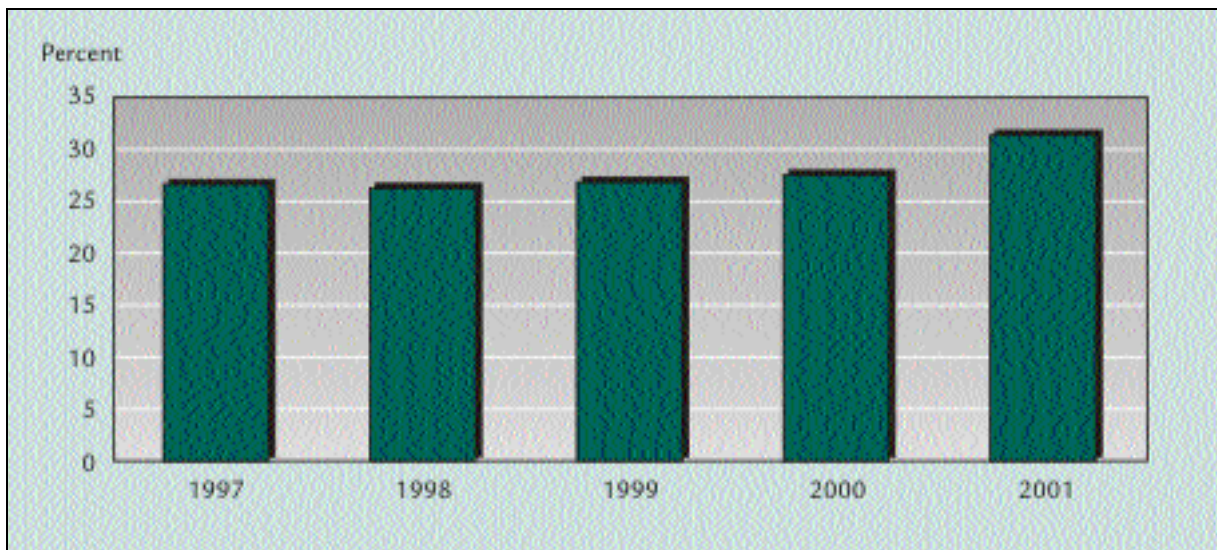


Source: Office of the Auditor General of British Columbia

Exhibit 2.17

Own-source Revenue to Gross Domestic Product (GDP), 1997 to 2001

Provincial revenue, net of federal transfers, as a percentage of GDP in British Columbia



Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 2.18 shows the percentage of the government-to-government transfers to own-source revenue for British Columbia, for the five years ending March 31, 2001. The province's dependence on the federal government for funding has remained relatively stable over the years. A slight increase occurred in 2000 because of additional contributions received from the federal government as the result of a change in federal fiscal policy in that year toward all provinces.

The government of British Columbia often borrows in foreign currencies. However, to minimize its vulnerability to foreign currency swings, the government enters into derivative contracts such as currency swaps and forward contracts for most foreign-denominated debt. These contracts ensure that debt repayments are fixed in Canadian dollars. For many years, information concerning public debt issued in foreign currencies has been included in a note to the government's financial statements. The note discloses any "hedging" through foreign currency derivative contracts.

Exhibit 2.19 shows the non-hedged foreign currency debt as a percentage of the total debt of the Province of British Columbia, for the five years ending March 31, 2001. The increase in 2000 was due mainly to the issuance of additional non-hedged foreign-denominated debt during the year.

The ratio of non-hedged foreign currency debt to total government debt shows the degree of vulnerability of a government's public debt position to swings in foreign currency. Tracking monies borrowed by the government in currencies other than the Canadian dollar is important because of the uncertainties associated with exchange rates when repayment comes due.

Economic Trends

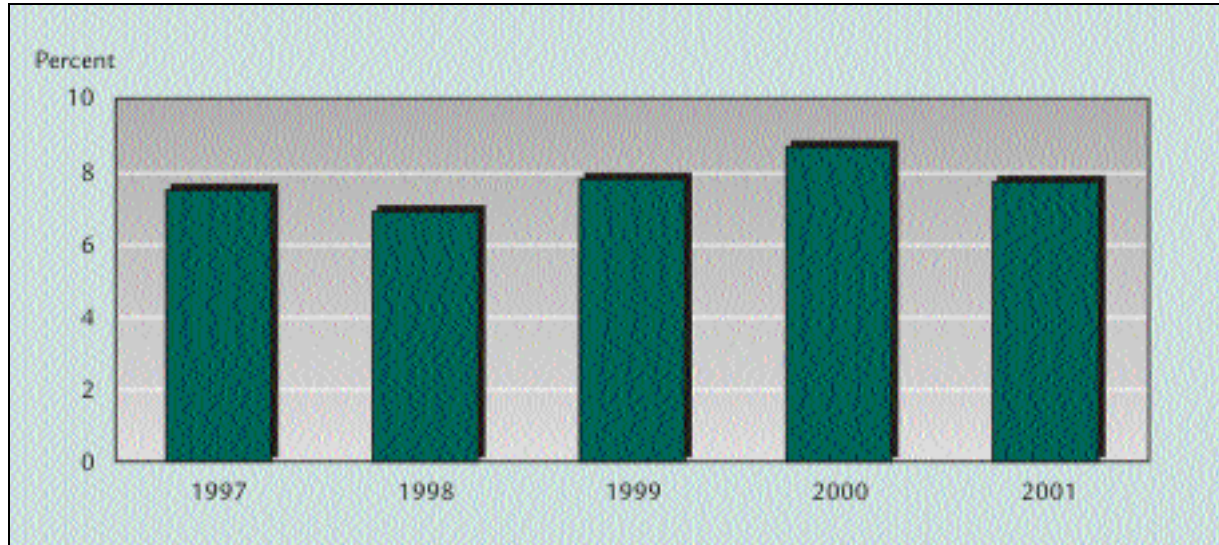
The government's business can influence, and be influenced by, changes in the economy. On the income side, the taxation, resource and other government revenues are closely tied to the performance of British Columbia's economy. A vibrant economy will normally produce greater revenues. In turn, spending that revenue in the province can play an important role in stimulating economic growth.

In the 2000/01 fiscal year, in comparison to other western Canadian jurisdictions and Ontario, British Columbia experienced relatively lower inflation, higher unemployment, and lower (except compared to Manitoba) GDP per capita.

Exhibit 2.18

Government-to-Government Transfers to Own-source Revenue, 1997 to 2001

Federal transfers as a percentage of all other government revenue

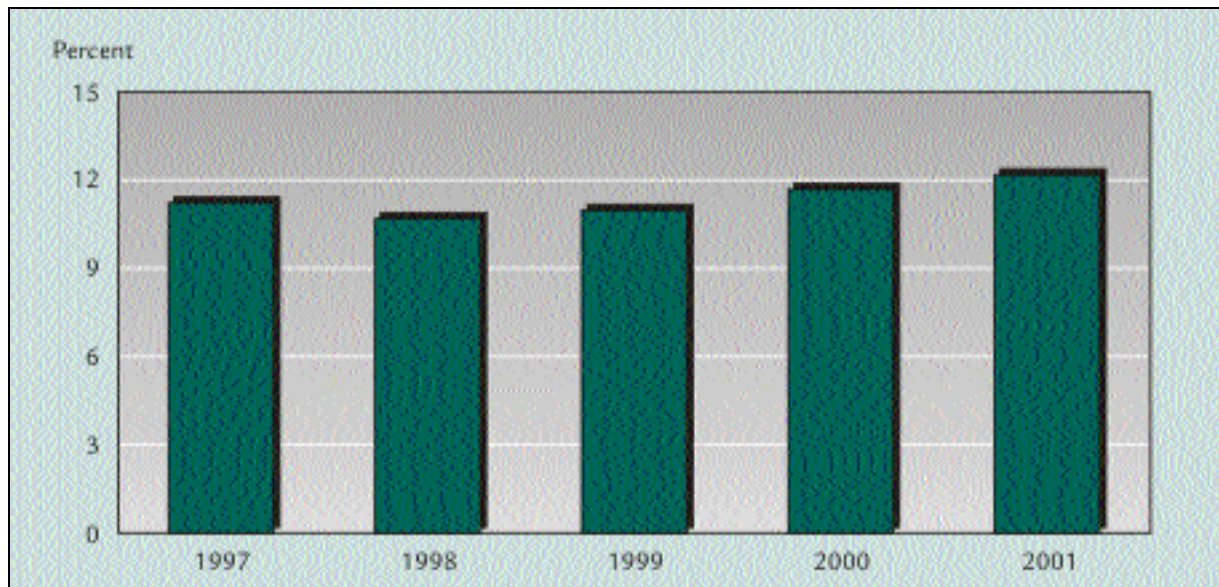


Source: Office of the Auditor General of British Columbia

Exhibit 2.19

Foreign Currency Debt to Total Government Debt, 1997 to 2001

Non-hedged foreign currency debt as a percentage of total government debt



Source: Office of the Auditor General of British Columbia; Ministry of Finance

Exhibit 2.20 compares inflation, unemployment and GDP per capita in all Western Canadian provinces and Ontario for 2001.

Comparing provincial statistical and economic information is not without problem. Much work needs to be done to make such comparisons relevant. For instance, statistical and economic information is constantly being updated, and this can often result in significant changes. It is therefore important to ensure that the date of such information is the same when interprovincial comparisons are being made.

The provincial rate of growth of GDP is an important indicator of economic performance. At 5.8% growth, British Columbia's economy performed better than projected in the Province's Budget 2000, which helps explain the overall improvement in the government's financial results in the 2000/01 fiscal year. This improvement, however, was largely due to high energy prices over the previous year which, based on information available in July 2001, is not expected to last.

Another widely used intergovernmental indicator of government financial performance is credit rating. As a service to lenders, credit rating agencies keep watch on changes in the provinces' financial condition and publicly report on them. In the view of these agencies, British Columbia has been able to keep its high standing in the international financial market, although its ranking has dropped from the highest rated province in Canada to the second highest rated province, after Alberta.

Exhibit 2.20

Economic Indicators for the Western Provinces and Ontario, 2001

British Columbia has high unemployment, low inflation and low gross domestic product (GDP) per capita

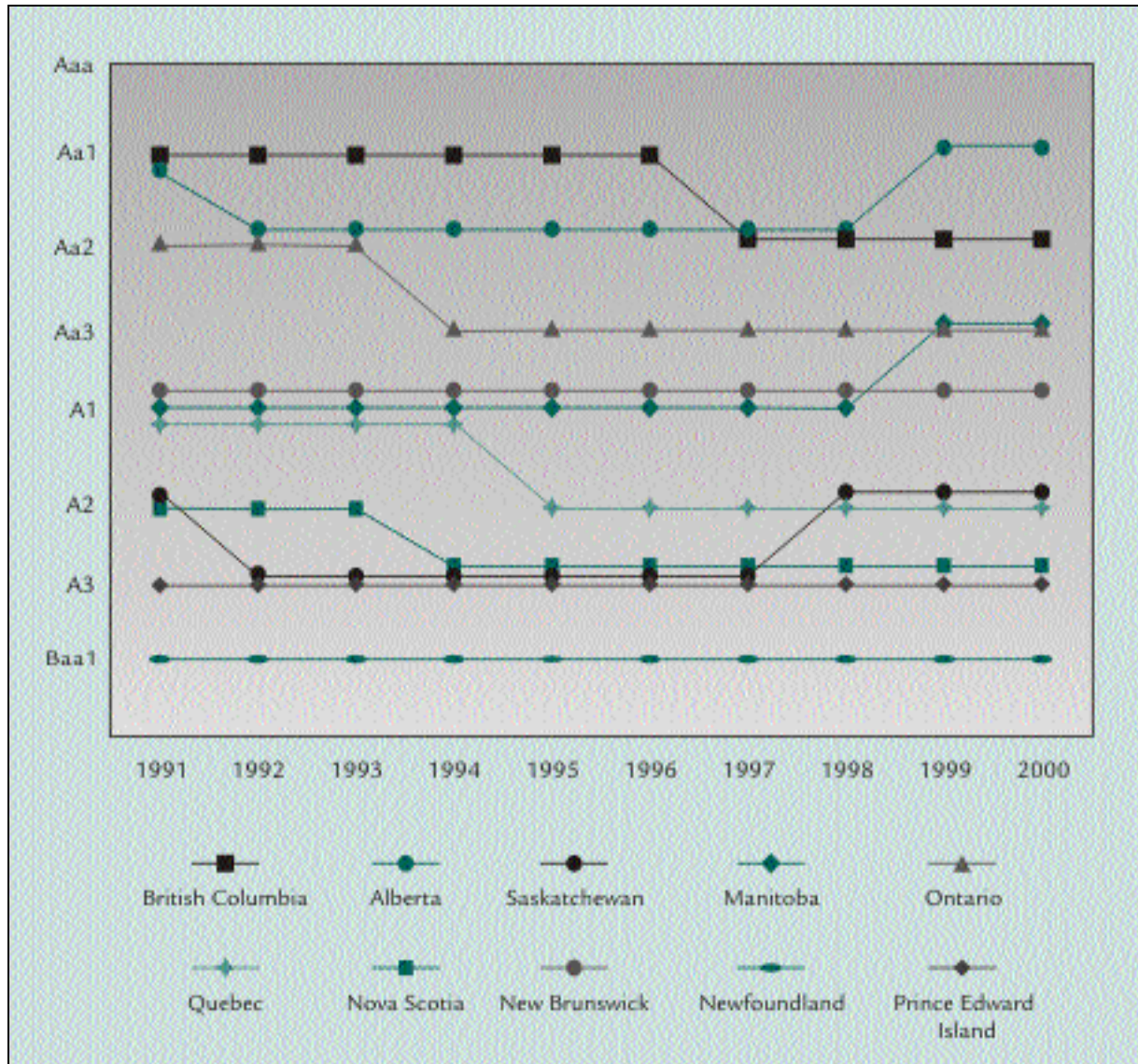
	Inflation %	Unemployment %	GDP per capita \$
British Columbia	1.86	7.2	31,400
Alberta	3.50	5.0	47,700
Saskatchewan	2.68	5.2	32,700
Manitoba	2.56	4.9	29,400
Ontario	2.86	5.7	36,800

Source: Statistics Canada

Exhibit 2.21 compares British Columbia's credit rating by Moody's Investors Service to the other provinces over the last 10 years.

Exhibit 2.21

Credit Rating of all Provinces, 1991 to 2000



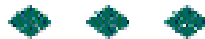
Source: Moody's Investors Service

Detailed Financial Information Framework, 1997 to 2001

Revenue and Expense for the Years Ended March 31 (Amounts in \$ Millions)					
	1997	1998	1999	2000	2001
General programs					
Revenue					
Taxation	13,463	13,551	13,620	13,796	14,381
Natural resources	2,671	2,681	2,015	2,821	4,181
Federal transfers	2,173	2,065	2,398	2,855	3,061
Other	4,858	5,299	5,531	5,709	6,365
	<u>23,165</u>	<u>23,596</u>	<u>23,564</u>	<u>25,181</u>	<u>27,988</u>
Expense					
Health	7,456	7,820	8,102	8,814	9,421
Education	6,447	6,526	6,928	7,164	7,729
Social services	3,099	3,181	3,146	3,115	3,263
Transportation, protection, econ. dev.	3,940	4,568	4,635	4,337	4,560
General government, debt servicing	3,535	3,462	3,218	3,017	3,144
	<u>24,477</u>	<u>25,557</u>	<u>26,029</u>	<u>26,447</u>	<u>28,117</u>
	<u>(1,312)</u>	<u>(1,961)</u>	<u>(2,465)</u>	<u>(1,266)</u>	<u>(129)</u>
Enterprises					
Revenue					
BC Hydro	2,403	2,533	3,018	3,458	7,889
Insurance Corporation of BC	2,624	2,690	2,822	2,966	2,872
BC Liquor Distribution Branch	1,543	1,598	1,645	1,671	1,732
BC Railway Company	421	427	418	479	496
Other	893	1,036	1,531	1,806	1,507
	<u>7,884</u>	<u>8,284</u>	<u>9,434</u>	<u>10,380</u>	<u>14,496</u>
Expense					
BC Hydro	2,064	2,125	2,622	2,912	7,340
Insurance Corporation of BC	2,779	2,676	2,761	2,776	2,886
BC Liquor Distribution Branch	956	992	1,029	1,054	1,090
BC Railway Company	385	387	391	1,062	502
Other	625	778	1,111	1,281	953
	<u>6,809</u>	<u>6,958</u>	<u>7,914</u>	<u>9,085</u>	<u>12,771</u>
	<u>1,075</u>	<u>1,326</u>	<u>1,520</u>	<u>1,295</u>	<u>1,725</u>
Total annual surplus/(deficit)	<u>(237)</u>	<u>(635)</u>	<u>(945)</u>	<u>29</u>	<u>1,596</u>

Assets and Liabilities as at March 31 (Amounts in \$ Millions)					
	1997	1998	1999	2000	2001
General programs					
Financial assets	6,419	7,205	7,419	9,580	9,550
Liabilities	28,651	29,737	30,983	33,801	33,701
	(22,232)	(22,532)	(23,564)	(24,221)	(24,151)
Enterprises					
Assets					
BC Hydro	10,462	10,392	10,716	10,617	11,467
Insurance Corporation of BC	5,263	5,630	5,957	5,974	5,909
BC Liquor Distribution Branch	89	84	91	92	111
BC Railway Company	1,647	1,759	1,920	1,387	1,372
Other	299	574	615	744	528
	17,760	18,439	19,299	18,814	19,387
Liabilities					
BC Hydro	8,981	9,136	9,363	9,065	9,776
Insurance Corporation of BC	5,053	5,406	5,672	5,499	5,428
BC Liquor Distribution Branch	89	84	91	92	111
BC Railway Company	515	590	765	852	846
Other	181	461	523	561	225
	14,819	15,677	16,414	16,069	16,386
	2,941	2,762	2,885	2,745	3,001
Net liabilities	(19,291)	(19,770)	(20,679)	(21,476)	(21,150)
General infrastructure assets	18,248	18,236	18,415	19,241	20,511
Accumulated surplus/(deficit)	(1,043)	(1,534)	(2,264)	(2,235)	(639)

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information



response of the ministry of finance

Introduction:

We wish to thank the Office of the Auditor General of British Columbia (OAG) for the opportunity to review and comment on Report 4: Monitoring the Government's Finances. This report goes beyond the normal commentary on the Summary Financial Statements, and accounting policies and practices, and provides the Auditor General's view of what would be complete financial reporting. It also reiterates some long standing issues, e.g., adoption of generally accepted accounting principles (GAAP), which are being addressed.

With respect to the comments applicable to the Summary statements, we will continue to review and consider all the OAG recommendations in preparing the 2001/02 Public Accounts. We remain committed to presenting understandable and useful financial statements.

In addition to the Public Accounts, the province provides information very similar to what is suggested by the Auditor General in the Debt Statistics report, the Financial and Economic Review, and the Quarterly Reports published each year by the government. The Auditor General's report will be useful as the Ministry of Finance reviews its current reporting documents and deals with the question as to where and how such information should best be reported.

Overall, financial reporting in its various forms, including the annual Public Accounts, is the responsibility of management. The reports are, therefore, prepared with concern for their usefulness to readers and in accordance with the requirements of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA).

Comments on specific recommendations:

Recommendation: The government implement generally accepted accounting principles (GAAP) as soon as possible.

Generally Accepted Accounting Principles

The province is committed to the implementation of GAAP and amended the Budget Transparency and Accountability Act to require GAAP by 2004/05. Although government's reporting is already very close to GAAP for senior governments, moving to GAAP is a significant implementation challenge. The two areas in which the government is not consistent are the exclusion of the Schools, Universities and Institutes, Colleges and Health Care Organizations

(SUCH sector) from the entity, and the treatment of prepaid capital advances and tangible capital assets. We disclose these differences in Note 1 to the Summary Financial Statements and have provided supplementary information on the impact of these differences.

Appropriate Financial Framework

A) The inclusion of the SUCH Sector in the audited financial statements

As noted above, this question will be resolved as part of our progress in complying with the legislated move to GAAP by fiscal 2004/05. An implementation plan has been developed. The full consolidation of the SUCH sector, however, is more than a simple accounting task. There are significant implications for the entire financial framework, including budgeting, forecasting and questions of local versus provincial accountability, which require consultation with the numerous entities.

As we proceed, we will also be monitoring the ongoing policy discussions at PSAB as they review the nature of government reporting entities and refine the standards of inclusion and exclusion from a consolidated summary entity. It is possible that new recommendations will be made by PSAB regarding both who should be in the reporting entity and how they should be reflected in the financial statements. It is to these final policies that we are, and will be, committed.

In the interim, we will continue to present supplementary information concerning the overall financial framework in the form of additional detailed schedules supporting the main summary statements (see the “Supplementary Information” section in the Public Accounts).

B) Form of Financial Statements

The government is committed to openness and transparency and, therefore, to providing clear information to inform British Columbians on the state of its finances. Aside from the required PSAB recommendations, the content and format of the annual report is management’s responsibility. Except that we use a separate schedule for Net Liability, the form currently used to present financial information for the British Columbia government is both comparable with other senior governments, and consistent with current PSAB requirements.

In discussing Report 4, we have been advised by the Office of the Auditor General that they wanted to go beyond their normal commentary on the form of the financial statements. The Auditor General wanted to put forward other possible disclosure statements to better inform the reader. While we accept these as comments, we are concerned with the formats used.

The OAG has presented statements that move away from the traditional format currently recommended by PSAB. For example, the Auditor General has incorporated Gross Domestic Product (GDP) numbers as part of the Statement of Financial Position. In addition, the whole of government activity has been separated into two components described as “General Programs” and “Enterprises,” effectively creating two separate bottom lines. When calculating total revenues and expenses for the government, the Auditor General is combining the two numbers. As will be noted below, this can interfere with a proper evaluation of the results of the taxpayer-supported General Programs and comparison of operations with other provinces.

We are not convinced that this is better or more understandable information than the present schedules which incorporate the net results from Enterprises, for the following reasons:

- *Statistics Canada continues to revise its early estimate of provincial GDP as new information becomes available. Often their revisions significantly change original estimates. The validity of such an amount on audited financial statements would be subject to question.*
- *The presentation of enterprise corporations would be inconsistent with the practices of other provinces and PSAB recommendations.*
- *The proposed format would require detailed budget presentation and restructuring to maintain the comparability of actual Public Accounts numbers to Budget.*
- *There would also be potential concerns by enterprise corporations operating in a competitive market over disclosure of key financial data to their competitors.*

The Office of the Comptroller General will continue to explore these presentation possibilities with the OAG, and to research with other provinces and standard setters regarding financial condition reports.

Recommendation: That the government use the indicators of financial condition identified by the CICA, and other important financial and economic measures, to inform the legislators and citizens of British Columbia of the state of the government’s finances.

The use of financial indicators aided by graphic comparisons of key financial data with economic trends was reviewed in a published research project completed by the CICA in 1997. They were presented as options to be considered by senior governments and are not fully adopted by any government. It has not since been amplified or made part of their recommendations.

Nevertheless, financial indicators are useful and are currently part of our reports. For example, the Public Accounts for fiscal 2001, page 103, provide seven key indicators. Numerous other indicators are presented in the Debt Statistics report (published concurrently with the Public Accounts), and in the Fiscal and Economic Review, budget documents and quarterly reports. These continue to be issues of comparability of indicators between provinces.

We have a specific concern about including the gross trading revenue and expense transactions of Enterprises in such a comparison as Exhibits 2.3 and 2.6. The OAG has combined enterprises and other organizations to display total revenue and expense for government in a way that is not consistent with the CICA guidelines. For example, the anomalous line for Enterprises includes the gross volumes of BC Hydro power trading. Trade comparisons of government revenues and spending are particularly difficult when including utility items such as energy trading revenues and expenses.

As the government continues to enhance its financial and other performance reporting, there will need to be a considered review of what is the best model for presenting the information to our stakeholders and financial statement users. The information needs of these users are in themselves very different, e.g. the general public and debt rating agencies, and no one document or format is expected to meet all their needs. We will continue, therefore, to work closely with our statement users and the Auditor General in designing the best reporting package or packages. This will also require us to keep abreast of the evolving PSAB requirements and practices in other provinces.

There is also a concern in that we must present financial and non-financial information on the same periodic basis. It appears in the OAG report there is the use of fiscal year financial information together with calendar based economic data.

Summary:

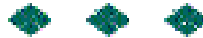
The OAG has presented some interesting reporting options by taking currently published schedules, re-formatting and re-grouping the information, and including economic and financial indicators.

We feel considerable care needs to be taken in including economic and non-financial information together and that we should do so only as it would enhance the meaning of the financial information for all users. This may mean including some indicators with summary statements, and maintaining separate reporting for other information. In fact, this OAG report, since it goes beyond the Auditor General's normal review

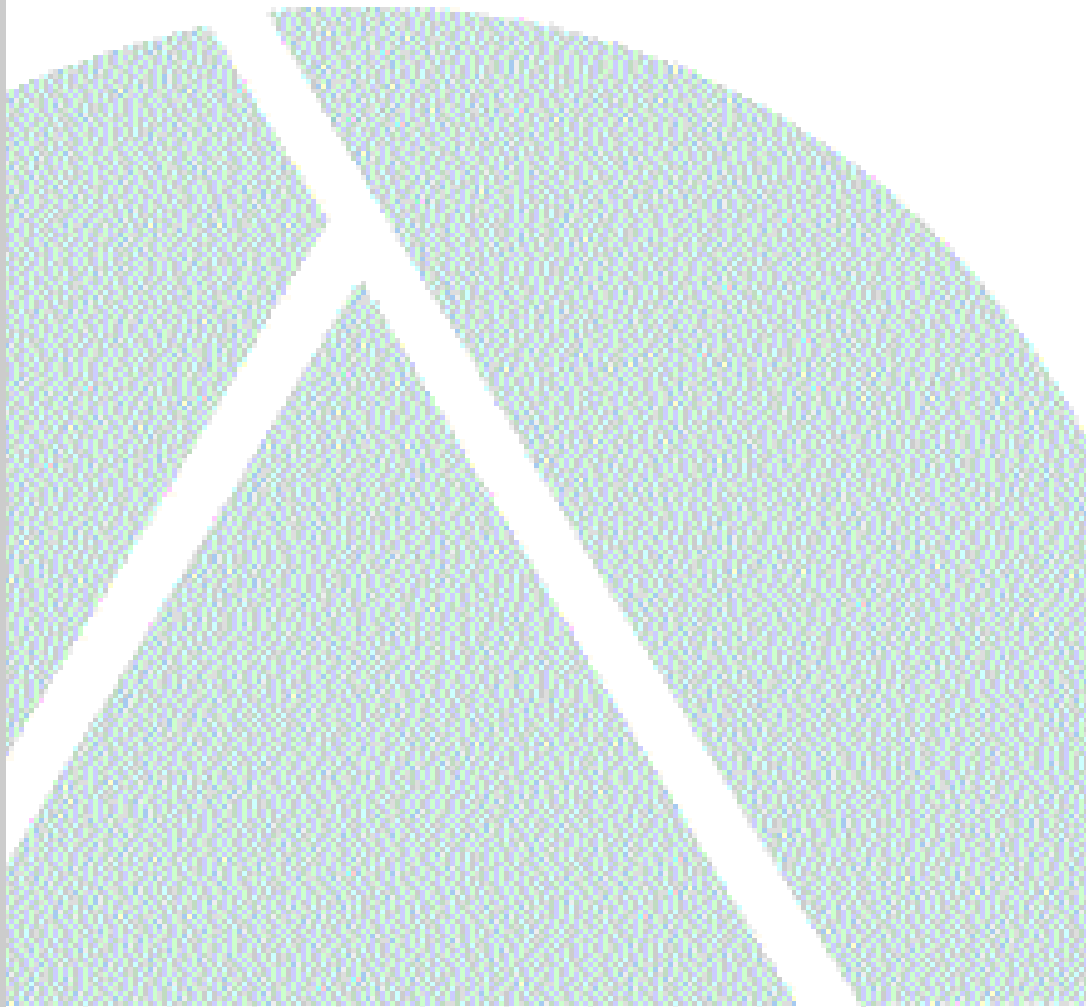
of financial statements, requires broader review and input. The discussion concerning how and where to present non-financial information in relation to financial statements is ongoing.

As management identifies and approves new and different reporting forms that enhance the utility of financial information, they will be implemented. The changes will include discussions with our users and, of course, with the Auditor General. In the meantime, the government is focusing on its commitment to implement GAAP by fiscal 2004/05.

January 2002



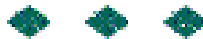
glossary



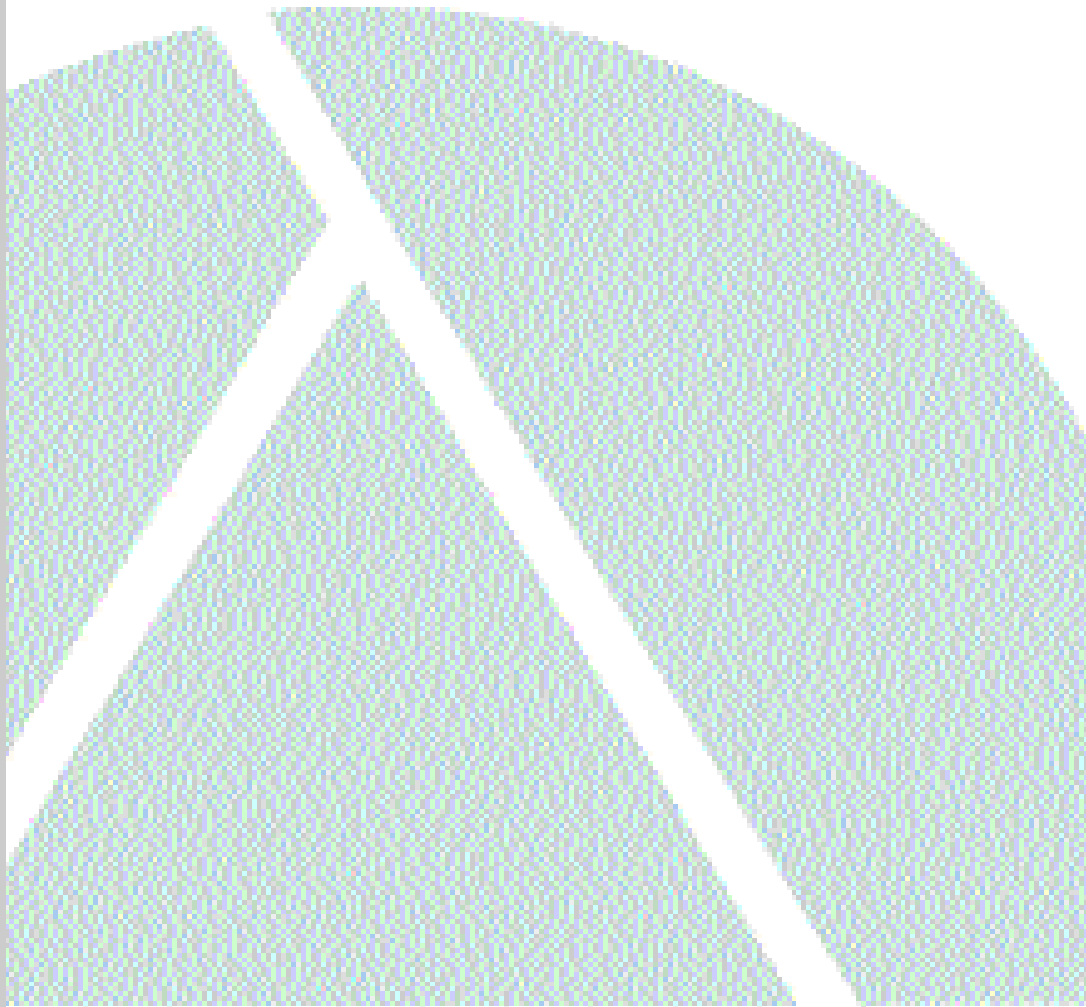
glossary

Accumulated surplus/deficit	The total of all past annual surpluses and deficits to date.
Annual surplus/deficit	The difference between the government's annual revenues and expenses.
Derivative contract	A "swap" or other financial instrument that is entered into with a third party, and is used to hedge interest rate, foreign currency or other risk exposures.
Enterprises	Also known as commercial, self-supporting, or modified equity enterprises. These are self-sufficient Crown corporations that sell goods or services to parties outside the government reporting entity.
Federal transfers	Funds received by the Province from the Federal government, such as the Canada Health and Social Transfer.
Financial assets	Assets of government (such as cash, investments, loans and accounts receivable) that can be converted to cash in order to pay government's liabilities or finance its future operations.
General infrastructure assets	Also known as capital assets, physical assets, tangible assets, non-financial assets, physical capital stock. These general program capital assets form the infrastructure necessary to provide services to citizens.
Generally accepted accounting principles (GAAP)	This refers to the accounting policies that government should follow in order to be consistent in its accounting practices with other, similar, organizations. The accepted authority for GAAP for Canadian governments is the recommendations of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA).
General programs	Those activities of government which are not carried out by its profit-oriented enterprises.
Government reporting entity	The group of organizations that are consolidated in the government's main summary financial statements.

Gross domestic product (GDP)	The money value of goods and services produced within a geographical boundary. GDP can be reported without adjusting for inflation (known as market value, current, or nominal GDP) or it may be discounted for the effects of inflation (real GDP). GDP in this report is not adjusted for inflation.
Hedging	Reducing potential exposure to foreign currency, interest rate or other risks. Often achieved by entering into derivative contracts with a third party.
Net liabilities	Defined as government's total liabilities less its financial assets, this is the residual liability amount that will have to be paid or financed by future taxpayers.
Public debt	Borrowings of the government. Debt generally consists of debentures, notes payable, capital leases and mortgages.
Public debt charges	Also known as the cost of borrowing, or debt servicing costs, this is the interest incurred by government on its borrowings.
SUCH sector	Refers to school districts, universities, colleges and health authorities.
Summary financial statements	The financial statements through which government reports its financial position and operating results.



appendices



appendix a

2000/01 Summary Financial Statements

Report of the Auditor General of British Columbia	
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appendix b

Office of the Auditor General: 2001/02 Reports Issued to Date

Report 1

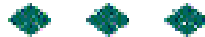
Managing Interface Fire Risks

Report 2

**Transportation in Greater Vancouver:
A Review of Agreements Between the Province and
TransLink, and of TransLink's Governance Structure**

Report 3

**Building Better Reports:
Public Performance Reporting Practices
in British Columbia**



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