Report 7: December 2012

OBSERVATIONS ON FINANCIAL REPORTING: SUMMARY FINANCIAL STATEMENTS 2011/12

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The Honourable Bill Barisoff
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Dear Sir:

As mandated under Section 11 of the *Auditor General Act*, I have the honour to transmit my 2012/2013 Report 7: *Observations on Financial Reporting: Summary Financial Statements 2011/12*.

This report contains my observations from my annual audit of the Province's Summary Financial Statements – the largest financial statement audit carried out in British Columbia. It also explains why I had to again qualify my audit opinion on government's Summary Financial Statements, for four significant departures from Canadian generally accepted accounting principles (GAAP).

The report also addresses:

- recommendations to government on other areas of the Summary Financial Statements that were not in accordance with GAAP, but on which I did not qualify my opinion;
- areas where government could improve the quality of its financial reporting in the Public Accounts;
- a summary of control weaknesses noted from audits from across the government reporting entity; and
- future changes in accounting standards and potential impacts on the Summary Financial Statements.

Overall, while government is meeting most of the basic requirements of financial reporting, there are still significant improvements it can make. British Columbians deserve easy-to-understand financial reporting, with a clean opinion, from their government.

John Doyle, MAcc, FCA
Auditor General

Victoria, British Columbia
December 2012

TABLE OF CONTENTS

TABLE OF CONTENTS

John Doyle, MAcc, FCA
Auditor General

The audit of government's Summary Financial Statements is a significant body of work for my Office. This is the largest financial statement audit carried out in British Columbia, involving approximately 148 separate government organizations and consuming thousands of hours of my staff's time, as well as that of many private-sector auditors.

My audit opinion for the 2011/12 fiscal year contains four audit qualifications, two of which have recurred several times over the last few years. Qualifications indicate that the Summary Financial Statements are not in compliance with Canadian generally accepted accounting principles (GAAP). Had government prepared and reported its Summary Financial Statements in full accordance with GAAP, the deficit for the year would have been $520 million higher, at $2,360 million.

Qualifications represent more than a simple disagreement between accountants – they indicate to users of financial statements that some of the information is not auditable or could be misleading. While qualified audit opinions are rare in the private sector, government has had 13 audit qualifications in its summary financial statements in the last 17 years. The persistence of qualifications has a relatively straightforward solution –government merely needs to comply with the standards set by the Public Sector Accounting Board. (To further explain the importance of audit opinions and provide a detailed explanation of qualified audit opinions, I have again released an information bulletin, available in the 'Reports' section of our website.)

Furthermore, for several years now I have been signaling about upcoming significant changes to Canadian accounting standards. We are currently in the midst of a significant changeover that will affect every organization across the government reporting entity by the end of next year. This involves significant effort by government, my staff and other public sector auditors. To assist with this transition, my Office recently published a revised set of model public sector financial statements and other guidance that reflect the latest changes to public sector accounting standards, which can be found in the 'Resources' section of our website.

At the same time that this transition has been occurring, I have also been reporting my considerable concern about government overriding the independent standard setting process. One of the qualifications this year (relating to government transfers) is likely to be many times its current size in the coming audit cycle because of government's actions.

Overall, government's financial reporting meets most of the basic requirements. However, while financial reporting is like a scorecard in some respects, it should also tell a more complete story of an organization's financial health. In this sense, government can make significant improvements to the transparency and usefulness of its financial reporting. British Columbians deserve easy-to-understand financial reporting from their government, with a clean opinion.

As in prior years, this report also includes a summary of internal control issues described in auditors' letters to the management of government organizations and their governing boards. Again, the persistence of these issues is an area of concern, when there should be few to none.

As well, this report also contains recommendations to government for improving its accounting and reporting of transactions, as well as explanations of other issues that were encountered during the audit and will be of interest to legislators and the public.

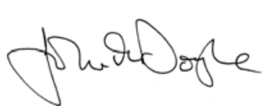
For all our public reports, we provide management the option of responding to our findings. Management has exercised that option and we include those comments within our report.

In its response, government has stated that it has made choices based on potential changes in accounting standards. The Auditor General is required to apply standards as they currently exist, not how they may be shaped in the future. In addition, the government's interpretation of some standards is inconsistent with the position of, not just our office but, the entire auditing profession (for example, government transfers).

Looking ahead to future reports regarding government's finances, I will continue to examine a number of topics, including:

- budgeting and forecasting by government;
- funding models in the health and education sectors;
- the quality of government's reporting on its finances outside of the Summary Financial Statements; and
- a continued emphasis on working capital management, and other aspects of financial management.

In closing, I wish to thank all staff in my Office and in the private sector audit firms who assisted in the audit of the 2011/12 Summary Financial Statements.



John Doyle, MAcc, FCA
Auditor General
December 2012

EXECUTIVE SUMMARY

THIS REPORT IS WRITTEN TO INFORM legislators and the public about the Auditor General's opinion on the 2011/12 Summary Financial Statements of the Province of British Columbia, and to discuss significant findings resulting from the audit. The report is also intended to encourage improved practices in financial reporting and management.

On July 25, 2012, the provincial government released the audited Summary Financial Statements for the year ended March 31, 2012.

The Summary Financial Statements report the consolidated financial results of the bodies that make up the government reporting entity. That entity includes:

- the Legislative Assembly,
- 8 legislative offices,
- the Office of the Premier,
- 16 ministries, and
- 148 other organizations, including Crown corporations, school districts, universities, colleges and health organizations, and over 80 subsidiaries.

The Summary Financial Statements are an important document for the people of British Columbia, providing an indication of the financial well-being of the Province and accountability for monies used by government over the 12-month period.

The audited Summary Financial Statements are part of government's Public Accounts (available at www.fin.gov.bc.ca/ocg/pa/11_12/Pa11_12.htm). The Public Accounts also include audited debt-related statements and unaudited information, such as government's financial statement discussion and analysis report and information about the Consolidated Revenue Fund and the provincial debt.

As required by the *Auditor General Act*, the audit of the Summary Financial Statements was conducted in keeping with Canadian generally accepted auditing standards (GAAS), prescribed by the Canadian Institute of Chartered Accountants. Under the Act, the Auditor General is the auditor of all central government operations, including all government ministries.

The extent of work performed for government organizations is based on a detailed assessment of risk at both the sector and government organization level. This assessment and the level of involvement the Auditor General has in each audit are described in the Financial Statement Audit Coverage Plan. That plan was presented to the Select Standing Committee on Public Accounts for its review and approval in October 2010.

KEY OBSERVATIONS RESULTING FROM THE AUDIT

1. *Accounting and auditing standards in Canada are changing to be more consistent with international standards.* However, we found several instances where government did not follow generally accepted accounting principles (GAAP). In four instances, these departures from GAAP resulted in qualifications of the Auditor General's opinion.

2. The purpose of the Financial Statement Discussion and Analysis (FSD&A) is to expand upon and explain information contained in the consolidated financial statements. This is an opportunity for government to explain variances in the financial results from year to year and variances from budget to actual results. However, government did not provide an adequate explanation of variances from budget in its current FSD&A.

3. *Issues of control in government and government organizations are increasing.* Government should have a process in place to classify control issues identified by the auditors and a strategy for resolving them.

We concluded that, in the Summary Financial Statements 2011/12, government chose accounting standards and presentation methods that reduce volatility in reported income. Reducing volatility means it is easier to meet balanced budget targets.

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WE RECOMMEND THAT GOVERNMENT

1. Report to the public in accordance with accounting standards developed by Canadian independent standard setters (page 13).

2. Provide all relevant information within the Financial Statement Discussion and Analysis, supported by financial statement results, to explain how it performed as fiscal stewards of public funds (page 14).

3. Review how accountability frameworks, including annual balanced budget requirements, interact to influence decision-making across the government reporting entity. The framework should be designed so that appropriate incentives are in place to encourage sound financial management (page 17).

4. Implement a process to ensure that all management letter points are followed up and resolved on a timely basis (page 18).

5. Not classify the Transportation Investment Corporation as a government business enterprise and instead consolidate it on a line-by-line basis in accordance with Canadian public sector accounting standards (page 22).

6. Accrue a liability for the deep-well credits as they are earned by the oil and gas producers, as required by Canadian public sector accounting standards (page 23).

7. Record government transfers in accordance with Canadian public sector accounting standards (page 23).

8. Ensure that the Summary Financial Statements include financial information relating to all government business enterprises, in accordance with Canadian public sector accounting standards (page 24).

1. IMPLICATIONS OF CHANGING STANDARDS

Canadian generally accepted accounting principles: the key to credible financial statements

Government is a complex organization in which significant financial transactions and money flow take place. It is therefore essential that the accounting policies chosen to record and report those transactions reflect best practices for: 1) ensuring all transactions are properly accounted for; 2) making financial information understandable; and 3) conveying the substance of what actually happened.

To help it accomplish this end, governments follow Canadian generally accepted accounting principles (GAAP).

The financial reporting environment in Canada has recently undergone significant changes that affect both the private and public sectors. The Accounting Standards Board of the Canadian Institute of Chartered Accountants (CICA) is responsible for establishing accounting standards in Canada. In turn, the CICA's Public Sector Accounting Standards Board (PSAB) has the authority to set accounting standards for the public sector.[1]

PSAB is an independent body that establishes generally accepted accounting principles for:

- governments, and
- government organizations consisting of Crown corporations and government not-for-profit organizations such as school districts, universities, colleges and health organizations (commonly referred to as the SUCH sector).

While the recommendations of PSAB are not mandatory given the sovereignty of each provincial and territorial government, they reflect best practices in public sector accounting. These recommendations are the yardstick by which auditors determine what type of opinion is provided on the financial statements of a reporting entity. By adopting the recommendations, government demonstrates its commitment to carrying out high-quality financial reporting and producing credible, consistent financial statements that are comparable with those of other jurisdictions.

1 *Source: http://www.frascanada.ca/public-sector-accounting-board/index.aspx*

The Summary Financial Statements of the federal and provincial governments are all currently prepared in accordance with PSAB standards.

Deviations from GAAP by British Columbia

We expected government to report to the public in accordance with GAAP. However, we identified two key areas where government, through legislation, has deviated from (or is planning to deviate from) presenting its results this way.

Section 23.1 of the *Budget Transparency and Accountability Act* requires the provincial government and its organizations to conform to the set of standards and guidelines that make up GAAP for senior governments in Canada (the PSAB standards). However, as we noted last year, the Province has now amended the Act to allow the government to modify Canadian GAAP as it chooses to.

To date, the Province has passed two regulations under the Act that override Canadian GAAP.

- BC Regulation 257/2010 – Last year, government directed BC Hydro to use a U.S. accounting standard (FAS980 Regulated Operations) to account for the effects of rate regulation. The regulation came into effect in 2012/13.

  However, the International Accounting Standards Board (IASB) has not yet reached a consensus about permitting rate-regulated accounting. Canadian accounting standards permit use of rate-regulated accounting until 2013/14.

  In addition to the uncertainty about IASB's decision on this standard, we noted that the Regulation includes an important exception to applying the U.S. rate-regulated accounting standard. Namely, it omits the requirement that the regulator must be independent of those being regulated.

  By directing BC Hydro to apply rate-regulated accounting when doing so may not be permitted under Canadian GAAP (when reporting under International Financial Reporting Standards), the Province will be modifying independent accounting standards to legislate accounting results.

  The government did not consult with our Office before implementing this significant change to its policies. Furthermore, this issue has additional long-term implications, as discussed in the section "Rate-regulated Accounting" on page 30.

- B.C. Reg. 198/2011 – This regulation directs government organizations to continue the historical practice of deferring government transfers. Doing so, however, has prevented several government organizations from complying with PSAB standards for such transactions. This had a significant impact on the auditor's reports for those organizations in 2011/12. For more information on this, see "Government Transfers/Deferred Contributions" on page 28.

In all, 10 organizations received non-GAAP compliance audit opinions and one organization received a modified GAAP audit opinion because of how they treat government transfers under B.C. Reg. 198/2011.

The number of organizations receiving compliance and/or modified audit reports is expected to increase substantially in fiscal 2012/13 for two reasons:

- First, the new government transfers section will further restrict the conditions under which contributions' revenue may be deferred and then recognized in future periods.
- Second, over 100 organizations in the SUCH sector will be transitioning to public sector accounting standards. These organizations typically record significant deferrals of government transfers. It is expected that most, and maybe all, SUCH sector audit reports issued in fiscal 2012/13 will be either non-GAAP compliance opinions or modified (qualified) GAAP opinions as described in the section "Non-GAAP audit reports" on page 26.

This means that the majority of the 148 government organizations in the government reporting entity may receive these types of audit reports as their financial statements will not be compliant with GAAP.

As a result, there was a qualification of the Summary Financial Statements in fiscal 2011/12 in relation to the deferral of federal and other non-provincial government transfers reported in the financial statements of the BC Transportation Financing Authority.[2] As the impact of this regulation on the government reporting entity increases next year, so will the impact on the Summary Financial Statements as more federal and other non-provincial transfers do not get reported as they should under GAAP.

In 2011/12, federal and other non-provincial contributions of $5.3 billion were recorded as deferred revenues in the Summary Financial Statements. Many of these may not meet the criteria for deferral under the new government transfers standard.

An important aspect of Canadian GAAP is the objectivity of financial reporting. The principles are developed by independent standard setters, and so are free of the bias of those who are responsible for preparing financial statements. Independence in developing accounting standards is extremely important given that the goals of those who prepare financial statements are typically not the same as the goals of those who rely on the objectivity of the information provided.

For this reason, our Office is very concerned that government has taken steps to modify independently developed standards as described above.

The implications of these deviations from Canadian GAAP are far reaching. The deferral of rate-regulated expenditures and the deferral of contributions of revenues obscure the true financial position of government. Taxpayers receive reduced transparency and accountability from their government. And, to the extent these issues also prompt our Office to qualify our audit opinion on the Summary Financial Statements, the accounting policies selected by government could ultimately impact the credit rating of the Province and the cost of debt.

2 When a government organization defers contributions from non-provincial sources, these amounts are also reported as deferred revenue in the Summary Financial Statements.

In fiscal 2012/13, we will work with government organizations and private sector auditors to obtain the information required to determine the impact of non-compliance with GAAP across the government reporting entity. If we are unable to obtain the information needed to quantify the impact of non-compliance, the result may be a limitation in the scope of the Auditor General's opinion.

RECOMMENDATION 1: ***We recommend that government report to the public in accordance with accounting standards developed by Canadian independent standard setters.***

2. UNDERSTANDING FINANCIAL PERFORMANCE

Reporting on performance

The Financial Statement Discussion and Analysis (FSD&A) contained in the Public Accounts provides highlights and commentary on the Province's financial performance.

The purpose of an FSD&A is to enhance users' understanding of an entity's financial position and results of operations, thus enabling the users to make informed decisions and judgements. The FSD&A also enables the entity to demonstrate its accountability for the resources entrusted to it.[3]

We identified two weaknesses in the government's approach to explaining its financial performance in 2011/12:

- Although government is generally providing users with some information they need to make decisions, the information is not contained in one document, nor does it always tell the full story.

  For example, according to the *PSAS Statement of Recommended Practice 1: Financial Statement Discussion and Analysis* concerning the public sector accounting standards, an entity should focus its risk discussion on the significant risks and on those risks that are likely to occur and may have significant financial implications. The entity should discuss the potential impact of these risks, and the strategies and techniques adopted for managing each risk. However, the risks government identified on page 27 in its FSD&A are mostly generic, and in most instances provide no assessment of the potential impact or the specific strategies for managing the risk.

  We note that government did explain some of the risks in more detail in the Budget and Fiscal Plan 2012/13 to 2014/15, but that is a separate document – not part of the Public Accounts – and was published in February 2012.

3 Modified from the Public Sector Accounting Standards *Statement of Recommended Practice 1: Financial Statement Discussion and Analysis.*

This example is typical of a general theme we observed: much of the information we would expect to find in the FSD&A was scattered throughout other documents, such as the Budget and Fiscal Plan and the 2012 BC Financial and Economic Review.

Providing all the necessary information in one document makes it easier for users to perform their analysis and get the full story. We noticed that many of government's own Crown corporations, such as BC Hydro and BC Lottery Corporation, follow this approach.

- Explanation for the updates to financial forecasting is lacking.

  For example, the Budget and Fiscal Plan 2012/13 to 2014/15 forecast a deficit of $2.497 billion. Given how close the date of the plan's publication (February 2012) was to the financial year-end (March 2012), this forecast should have been reasonably accurate. However, the actual reported deficit in the Public Accounts totalled only $1.84 billion – a difference of over $650 million. Neglecting to explain this type of variance is a serious oversight by government, potentially leaving users uneasy and doubting the validity of government's future forecasts and budgets.

RECOMMENDATION 2: ***We recommend that government provide all relevant information within the Financial Statement Discussion and Analysis, supported by financial statement results, to explain how it performed as fiscal stewards of public funds.***

Balanced budget issues

"The main estimates for a fiscal year must not contain a forecast of a deficit for that fiscal year." Balanced Budget and Ministerial Accountability Act, Section 2

A balanced budget is achieved when revenues meet or exceed expenditures for a given year, so that government does not incur an annual deficit. Budgets project the level of public expenditure for the coming year, as well as the mix of taxation, borrowing and other revenue measures required to finance those expenditures.

The objective of a balanced budget law is to restrain government with respect to: spending levels; the level or mode of taxation; whether or when it can incur deficits; the use of budgetary surpluses; and the repayment of public debt.

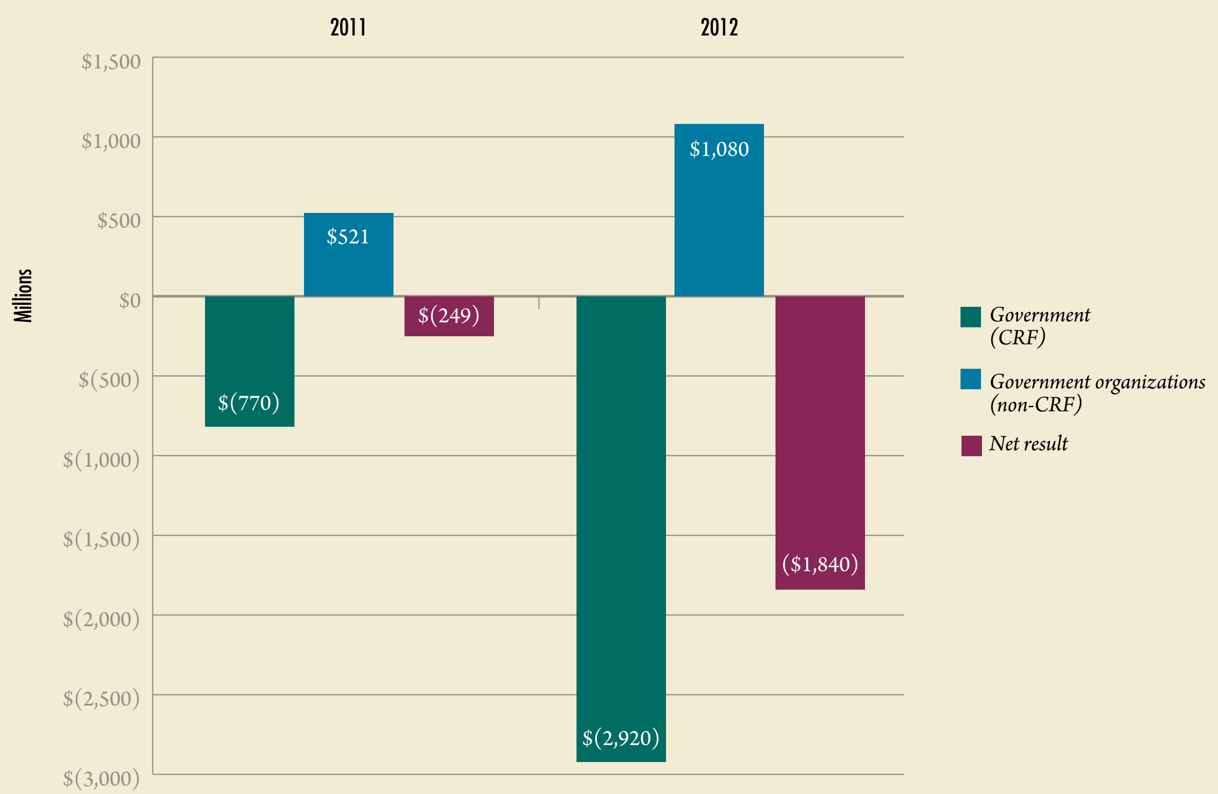
For the Province to balance its annual budget, it must balance its external revenue sources (including revenues earned by government organizations), with the expenditures of all of government.

To meet this objective, government places restrictions on the annual budgets of government organizations, generally requiring them to report an operating surplus (revenues exceeding expenditures) each fiscal year. However, an annual surplus reported by a government organization does not actually correspond to that organization's contribution to the consolidated annual surplus/(deficit) reported in the Province's Summary Financial Statements because, when consolidated, all contributions transferred from the Province to that organization are eliminated.

And although government organizations generally must report an annual surplus, the Consolidated Revenue Fund (CRF)[4] has no such requirement and pays contributions to government organizations at a level such that CRF expenditures normally exceed CRF revenues.

The CRF reported an annual deficit of $2,920 million in 2011/12 (2010/11: $770 million). This deficit was significantly higher than the deficit reported in the Summary Financial Statements after all government organizations were consolidated, which was $1,840 million in fiscal 2012 (2010/11: $249 million). This means the consolidated surplus/(deficit) each year involves a netting of surpluses reported by government organizations with a deficit reported in the CRF (see Exhibit 1).

Exhibit 1: Surpluses and deficits earned by Consolidated Revenue Fund (CRF) sources and non-CRF sources



Source: Province of British Columbia Public Accounts 2011/12, pages 42 and 113.

4 The Consolidated Revenue Fund is the government account that is drawn on whenever an appropriation is approved by the Executive Council and replenished through the collection of taxes, tariffs and excises.

For the majority of government organizations, contributions from the Province are the most significant source of revenues reported in their financial statements. However, in the consolidated results, government must balance expenditures (including the expenditures of government organizations) with revenues received from outside the provincial reporting entity (including non-provincial revenues reported by government organizations).[5]

While requiring government organizations to report annual surpluses does result in control over the government organization's contribution to the consolidated results, it does so in an indirect way. Not only does this method make it more difficult to predict a government organization's contribution to the consolidated annual surplus/(deficit),[6] it also negatively affects several aspects of financial management. For instance:

- *Excess working capital* – In August 2010, our Office reported that balanced budget requirements in colleges and school districts resulted in inefficient working capital management. The reason for this is that while revenues generally relate to cash flows received (or to be received shortly), many expenses do not.

  For example, expenses include recognition of the use of capital assets previously purchased (amortization) and also changes in long-term liabilities that may not be realized for many years, such as liabilities for employee future benefits. By requiring expenses to be balanced to revenues in each period, government organizations are receiving more cash than they are permitted to spend in each fiscal period. This has contributed to a build-up of cash and temporary investments within school districts in excess of $1 billion.

  The current state of excess working capital for the consolidated reporting entity is described in the section "Working Capital Management" on page 32.

- *Focus on short-term performance* – Financial statements are meant to present changes in financial position, yet balanced budget requirements focus on short-term annual performance. The various components of income relate to risks being managed both over the shorter term and the longer term.

  For example, annual surplus reflects changes in the market value of investments or long-term liabilities. In this context, a constraint on income would be akin to a person having less money to spend on groceries because their retirement savings declined in value within a fiscal year. While these shortfalls may have to be made up over the longer term, it may not make sense to force recovery within a one-year window, since investments fluctuate over time. Similarly, an increase in the value of long-term investments should not lead to increasing annual expenditures, since investment values may decline in the future.

The result of placing a constraint on annual surplus/(deficit) is that many of the decisions an organization has to make to comply with these requirements are not necessarily the best decisions from a business perspective.

5 Note that the *Balanced Budget and Ministerial Accountability Act* was revised during the economic downturn to remove the requirement that the estimates not forecast a deficit for the 2009/10 to 2012/13 fiscal years.

6 As an example, if the restrictions placed on government organizations was based on expenditures, except those expenditures funded by non-provincial revenues, then the fiscal control would be closely aligned with the actual impact on the consolidated surplus/(budget).

Our Office often hears the comment from entities that accounting is driving decision-making. We agree this can happen, but maintain that the issue is not one of accounting but of applying a narrow constraint on financial statements. Reading the financial performance story in financial statements is not a simplistic task, and using one simple measure of financial performance is problematic.

Government revised the *Balanced Budget and Ministerial Accountability Act* to allow the estimates to forecast a deficit, if necessary, for the 2009/10 to 2012/13 fiscal years. This change was made in response to declining revenue forecasts that exceeded what could be reasonably offset by short-term expenditure reductions. The rationale was that it would not make sense to dramatically cut expenditures in response to short-term revenue volatility.

This case highlights the point that when an accountability requirement is narrowly focused on short-term results, it might not lead to results that make the most sense over the long term. Furthermore, the fact that the requirement can be over-ridden reduces the level of accountability it was intended to achieve.

Other jurisdictions and large organizations instead focus on an array of financial indicators to ensure cash flow is being managed and that the organization is living within its means over both the shorter term and the longer term.

Financial statements, prepared in accordance with GAAP, are a comprehensive account of performance. The accountability mechanisms that measure how an organization has performed should therefore also gauge what the financial statements report in a comprehensive way.

RECOMMENDATION 3: ***We recommend that government review how accountability frameworks, including annual balanced budget requirements, interact to influence decision-making across the government reporting entity. The framework should be designed so that appropriate incentives are in place to encourage sound financial management.***

3. UNRESOLVED CONTROL ISSUES

In planning and performing an audit, the auditor takes into consideration an entity's governance, accountability and internal control over such areas as financial management, disclosure and presentation, and information technology. The auditor brings any control deficiencies noted to management's attention, along with recommendations. This is done in the form of a "management letter."

Management has the responsibility to weigh the costs of implementing recommended improvements against the benefits that will be achieved.

When the auditor issues a management letter to a government entity, we expect the entity to have a process for dealing with the recommendations made. Management letter recommendations are not issued on a whim. They are the result of the auditor assessing the situation, discovering an issue and finding the issue important enough to expect a formal response from management. We expect there to be an assessment of whether there is agreement by management with the point, an assessment of the urgency of the point and an estimate of how long it would take to implement any required changes.

We found two main areas of concern:

- *Many management letter points were not responded to in 2011/12* – In collating all the management letters issued to government entities that year, we found that approximately 20% of the points did not include a response from management of the entity. Some of the points not receiving a response dealt with matters such as computer system passwords not expiring, bank reconciliations not being performed and transactions not being reviewed by an appropriate person.

  We are concerned that lack of a process by government to deal with management letter points may result in important control weaknesses remaining uncorrected.

- *Central government has no process to either track outstanding issues or hold entities to account for resolving them* – For an entity the size of the provincial government, we recognize that tracking all issued management letter points and ensuring they are resolved can be a difficult task. However, the number of outstanding unresolved management letter points across the government entity is growing and a process to track them is needed. Such a process should classify points by how many are still outstanding, how many are not accepted, how many are still in the process of being implemented and how many have been completed or cleared.

For further information about management letter issues raised in 2011/12, see Appendix 2.

RECOMMENDATION 4: ***We recommend that government implement a process to ensure that all management letter points are followed up and resolved on a timely basis.***

UNQUALIFIED AUDIT OPINIONS ARE IMPORTANT

Audit reports are an auditor's way of communicating with the financial statement user. The report is an auditor's opinion on whether the financial statements of an entity are presented fairly. Audit reports can also bring to the reader's attention any concerns that auditors have with the financial statements.

Many people assume that the financial results of an entity are fairly presented, even without reading the attached audit report. A standard audit report – that is, one without modifications – indicates that the statements can be held to a higher level of reliability than can statements without such a report.

A qualification is a concern that an auditor has about the fairness of how something is accounted for or reported in a set of financial statements. When auditors issue a "modified report," they are indicating concerns with the availability of sufficient and appropriate information about the entity's financial operations or with the entity's compliance with Canadian generally accepted accounting principles (GAAP).

- *Implications for public corporations* – Public corporations (entities traded on a securities exchange) are required to have unqualified audit reports annually.

  In British Columbia, if a public corporation were given an audit opinion with a qualification, the British Columbia Securities Commission would normally place a "cease trade" order against the corporation. The public corporation then runs the risk of being delisted by the stock exchange on which it is traded.

  No data are available nationwide on how many modified audit reports are issued for public corporations in Canada, or how many cease trading orders have been issued in response to modified audit reports. Likely, however, qualifications on public corporations are extremely rare because of the severe consequences.

- *Implications for governments* – While no government in Canada is subject to public corporation requirements, a modified audit report could impact the jurisdiction's credit rating and cost of debt. Thus, ideally, no qualifications should have to be issued.

  According to the public sector accounting standards of the Canadian Institute of Chartered Accountants, "governments are held to a higher standard of accountability than a business or a not-for-profit organization."[7]

  That may be so, but in British Columbia, accountability for not complying with GAAP appears to have had little impact on government.

  Because the Auditor General found that the Province had not materially (that is, significantly) complied with GAAP, he modified his report on the provincial Summary Financial Statements for the fiscal year ended March 31, 2012. The reasons for these qualifications are explained in more detail below.

7 CICA Public Sector Accounting Handbook, section 1100, Appendix A, point 9.

As well, modified audit reports were issued to two of the approximately 148 organizations in the government reporting entity. And, as discussed in the section "Non-GAAP audit reports" later in this report, 10 organizations reported on a compliance basis because of material departures from GAAP.

1. FAILURE TO FULLY CONSOLIDATE THE TRANSPORTATION INVESTMENT CORPORATION

This qualification on the 2011/12 Summary Financial Statements concerns how the Province is consolidating the Transportation Investment Corporation. This reservation has been included as an audit opinion qualification each year since 2008/09.

In the public sector, the method of consolidating all the financial statements into the Summary Financial Statements depends on what type of organization the various entities are classified as. Public sector GAAP standards have specific criteria for classifying organizations. For the Summary Financial Statements, an entity can be part of:

- central government (e.g. a ministry);
- a government business enterprise (GBE; e.g. BC Lottery Corporation);
- a government not-for-profit enterprise (e.g. Community Living BC) or
- an "other government organization" (e.g. Oil and Gas Commission).

Most types of organizations are consolidated on a line-by-line basis. The exception is GBEs, which are consolidated on a modified equity basis.

When a government organization is consolidated on a line-by-line basis, each item from the organization's financial statements is added into the Province's financial statements after transactions with other government organizations and ministries are removed and adjustments are made to bring the items under the same accounting standards.

When a GBE is consolidated on a modified equity basis, transactions are consolidated differently. For example, only the initial contribution of money to the organization from the government (adjusted for annual earnings or loss) is included in the Province's financial statements. In addition, the accounting standards followed by the organization are not adjusted to be the same as government's, nor are adjustments made for transactions with other government organizations and ministries, apart from those involving the sale of assets.

Although the provincial government has chosen to define the Transportation Investment Corporation as a GBE and consolidate it on a modified equity basis, in fact the entity does not meet all four of the GAAP criteria defining a GBE – and should, therefore, be consolidated on a line-by-line basis.

The two criteria the entity does not meet:

1. It does not, as its principal activity, sell goods and services to individuals and organizations outside of the government reporting entity.

2. It does not, in the normal course of its operations, maintain its operations and meet its liabilities using revenues received from sources outside the government reporting entity.[8]

Currently, the Transportation Investment Corporation is responsible for the Port Mann Highway Improvement project, which includes replacing the existing bridge and building facilities to collect tolls from users. The new bridge is under construction. Until it is built and the toll booths are operational, the bridge will not be "selling" a service to anyone. The only revenue source the corporation has at present is the interest income being earned on funds obtained through government debt.

The financial model developed by the Transportation Investment Corporation forecasts that the entity will not be profitable before 2017/18. As well, many variables (such as, actual highway usage compared with planned) could affect the future revenue estimates in the financial model and therefore the date that the corporation does actually become profitable.

Clearly, the Transportation Investment Corporation does not meet the GAAP criteria of a GBE and should be consolidated on a line-by-line basis (see Exhibit 2).

Exhibit 2: Material changes to the Summary Financial Statements had the Transportation Investment Corporation been fully consolidated on a line-by-line basis

	Increase /(decrease)$ millions	
	2012	2011
Consolidated statement of financial position		
Loans for purchase of assets, recoverable from agencies	(1,779)	(1,148)
Accounts payable and accrued liabilities	519	440
Taxpayer-supported debt	1,779	1,148
Self-supported debt	(1,779)	(1,148)
Tangible capital assets	2,331	1,604
Consolidated statement of operations:		
Surplus (deficit) for the year	(97)	(20)

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

The increase to the deficit for the year relates to realized losses on interest rate hedging transactions that would be recorded as an expense if fully consolidated and converted to public sector accounting standards. Other line items in the consolidated statements of financial position and operations were also impacted but by lesser amounts.

The supporting consolidated summary financial statements by sector (pages 86 to 93 of the Summary Financial Statements) and the supporting statements for self-supported Crown corporations and agencies (pages 94 and 95) are also affected by this inappropriate classification of the Transportation Investment Corporation, and by the Summary Financial Statement changes described above.

Given these significant differences resulting from the consolidation, the Auditor General included a qualification in his opinion on the Summary Financial Statements.

RECOMMENDATION 5: ***We recommend that government not classify the Transportation Investment Corporation as a government business enterprise and instead consolidate it on a line-by-line basis in accordance with Canadian public sector accounting standards.***

2. FAILURE TO PROVIDE FOR DEEP-WELL CREDITS

This qualification on the 2011/12 Summary Financial Statements concerns the Province's failure to set up a provision, or liability, for the deep-well credits given to gas producers.

This matter also resulted in a qualification in the Auditor General's audit opinion on the Summary Financial Statements for fiscal years 2007/08 through 2009/10. This matter did not result in a qualification in fiscal year 2010/11, because the significance of the error had decreased and was not seen to be material to the Summary Financial Statements. However, it is included again in fiscal 2011/12 because of a significant increase in unrecorded liabilities.

Deep-well credits are used to reduce the amount of royalties that gas producers must pay to the Province when they extract gas from a well drilled to a specified depth. This incentive program, authorized by an Order-in-Council and established by regulation, was initiated to encourage further development of gas resources.

From an accounting perspective, deep-well credits are an expense incurred by the government to promote the growth of the oil and gas resource industry. They should therefore be recorded as a liability of the Province.

When an issue is raised by an auditor in one period but not corrected until a subsequent period, Canadian public sector accounting standards require the correction to be made in the current fiscal year (i.e. prospectively) rather than the results of previously reported periods being restated. Had a provision been made prospectively:

- accounts payable and accrued liabilities as at March 31, 2012, would have been greater by $702 million;
- natural resources and economic development expenses for the year then ended would have been greater by $702 million; and
- the deficit for the year then ended would have been greater by $702 million.

RECOMMENDATION 6: ***We continue to recommend that government accrue a liability for the deep-well credits as they are earned by the oil and gas producers, as required by Canadian public sector accounting standards.***

3. INAPPROPRIATE DEFERRAL OF GOVERNMENT TRANSFERS REVENUE

As already discussed, standards relating to how government transfers are accounted for are changing. The most significant changes will occur in fiscal 2012/13. However, application of the standards currently applicable resulted in the Auditor General qualifying his audit opinion on the financial statements of the BC Transportation Financing Authority for fiscal years 2010/11 and 2011/12.

This organization is consolidated into the Province's Summary Financial Statements and, to the extent these qualifications related to government transfers from non-provincial sources, the errors in the BC Transportation Financing Authority's financial statements were also errors in the Summary Financial Statements.

In fiscal year 2010/11, our Office notified government of the impact of these errors, but, as they were not material to the Summary Financial Statements, they did not result in a qualification in the Auditor General's audit opinion. In fiscal year 2011/12, the significance of these errors increased and, as a result, led to a qualification in the Auditor General's audit opinion on the Summary Financial Statements.

Had the correction been made prospectively:

- deferred revenues as at March 31, 2012, would have been less by $279 million;
- contributions from the federal government would have been greater by $200 million;
- miscellaneous revenue would have been greater by $79 million; and
- the deficit for the year then ended would have been less by $279 million.

RECOMMENDATION 7: ***We recommend that government record government transfers in accordance with Canadian public sector accounting standards.***

4. FAILURE TO DISCLOSE REQUIRED GOVERNMENT BUSINESS ENTERPRISE FINANCIAL INFORMATION

As noted above in the section discussing the failure to fully consolidate the Transportation Investment Corporation, when a government organization is classified as a GBE it is accounted for using the modified equity method. Under the modified equity method only the investment in the organization and the associated investment income are reported in the Summary Financial Statements. However, to provide additional information on the results of GBEs, public sector accounting standards require that condensed supplementary financial information[9] be included in the notes or schedules to the financial statements.

In fiscal year 2011/12, government failed to disclose this required information about the financial position and results of operations of certain subsidiaries of government organizations that are accounted for as GBEs. These included joint ventures of the Columbia Power Corporation and Columbia Basin Trust, and subsidiaries of certain universities.

Had this information been disclosed, the supporting statements for self-supported Crown corporations and agencies on pages 94 and 95 of the Summary Financial Statements:

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

This significant omission in the reporting of complete information of GBEs is the reason for a qualification being included in the Auditor General's opinion on the government's Summary Financial Statements.

RECOMMENDATION 8: ***We recommend that government ensure that the Summary Financial Statements include financial information relating to all government business enterprises, in accordance with public sector accounting standards.***

9 The information required is noted in paragraph 3070.60 of the *CICA Public Sector Handbook*.

INTRODUCTION / CANADIAN GAAP

Government is a complex organization with significant flows of money and transactions for which it can be difficult to properly account. It is therefore essential that the accounting policies chosen to record and report those transactions reflect best practices for making the financial information understandable and for conveying the substance of what actually happened. This is accomplished by following generally accepted accounting principles (GAAP).

In Canada, accounting standards for governments are issued by the Public Sector Accounting Board (PSAB). Not all transactions entered into by government are specifically covered by Public Sector Accounting Standards (PSAS). Further guidance for accounting transactions not covered by PSAS exists in the accounting standards issued by the Accounting Standards Board of the Canadian Institute of Chartered Accountants (CICA) for publicly accountable enterprises. Together, these standards are referred to as Canadian GAAP.

In rare situations not specifically covered by Canadian GAAP, guidance on appropriate accounting policies can also be obtained from standards issued by bodies empowered to do so in other jurisdictions. However, when a Canadian jurisdiction looks to other sources of GAAP, it must choose policies that are consistent with Canadian GAAP and PSAB's conceptual framework for accounting standards.

Reporting in accordance with Canadian GAAP should result in government financial statements that follow best practices. The financial statements should:

- provide an accounting of the full nature and extent of the financial affairs and resources that government controls, including those related to the activities of its agencies and enterprises;
- describe government's financial position in a way that is useful for evaluating government's ability to finance its activities, meet its liabilities and commitments, and provide future services;
- describe the changes in government's financial position, showing the sources, allocation and consumption of government's resources, the way government's activities affected its net debt and the way government financed its activities; and
- demonstrate accountability of government for the resources, obligations and financial affairs for which it is responsible.

1. FINANCIAL REPORTING FRAMEWORKS UNDER CANADIAN AUDITING STANDARDS

Last year in all of our financial statement audits, we noted that new Canadian auditing standards (CAS) had been implemented. These standards are based on international standards, enabling Canadian auditors to carry out consistent and comparable audits using standards that are accepted internationally.

One of the most significant changes in the standards related to financial statement audits has been a new audit reporting model. Under previous Canadian standards, audit opinions indicated whether the financial statements being audited were presented fairly in accordance with Canadian generally accepted accounting principles. However, under the new CAS, there are a number of acceptable financial reporting frameworks for general-purpose financial statements, including standards established by law, regulation and industry organizations.

The expansion of acceptable reporting frameworks allows governments to legislate accounting policies rather than follow independently established GAAP. The result can be financial statements not fairly presented.

In British Columbia, the provincial government has recently taken steps in this respect by amending its *Budget Transparency and Accountability Act* to allow the Province to modify Canadian GAAP at its own will (discussed further below).

This, in our view, is unfortunate and we remain very concerned that government is choosing to override the independent standard-setting process.

Canadian public sector accounting principles are highly respected in Canada and internationally, and it has taken many years for these principles to reach the point where they are generally accepted by Canadian governments and readers of their financial statements. Readers have come to expect that government's financial statements have been prepared in accordance with these principles.

2. NON-GAAP AUDIT REPORTS

As discussed in previous sections, changes to the CAS have expanded the range of acceptable reporting frameworks to include non-GAAP compliance frameworks. However, the latter come with conditions.

For example, a financial reporting framework that has been established by a law or regulation is only acceptable as an appropriate reporting framework under CAS when the requirements of the framework are still in line with the financial reporting standards of an established standard-setting organization (e.g. PSAB). When requirements of a legislative framework depart from established standards, such as accounting for government transfers under the Restricted Contributions Regulation, the framework is deemed to be unacceptable even if all other requirements are met.

So, if a government organization chooses to describe its reporting framework as being in accordance with GAAP, then the auditor would report in accordance with GAAP, but would include a qualification in the audit opinion to explain the impact of the inappropriate deferral of government contributions.

Alternatively, a government organization could describe its reporting framework as a compliance framework, meaning one it has been directed to follow by a particular law or regulation. The organization would also have to describe in the notes to the financial statements the differences between the compliance framework and GAAP. If an organization opts to describe its reporting framework in this way, then assurance standards would permit the auditor to issue a clean audit opinion in accordance with a compliance framework instead of a GAAP framework.

While the compliance approach avoids a qualification in the auditor's report, the report must not use wording that implies that the financial statements are fairly presented. Additionally, the auditor must add an "emphasis of matter" paragraph to his or her report that draw readers' attention to the alternative basis of accounting and the additional disclosures included in the statements.

Thirty six government organizations transitioned to a new financial reporting framework in fiscal 2011/12. Of those:

- 6 transitioned to international financial reporting standards;
- 10 transitioned to a non-GAAP compliance framework and received unqualified compliance audit reports; (Exhibit 3)
- 1 transitioned to PSAS and received a qualified GAAP audit report (Exhibit 3); and
- 19 transitioned to PSAS and received an unqualified GAAP audit report.

The 19 organizations that received an unqualified GAAP audit report did not receive government transfers and hence were not required to apply the Restricted Contributions Regulation in their financial statements.

Exhibit 3: Government organizations issued compliance or modified opinions in 2011/12

Government organization	Audit opinion
British Columbia Pavilion Corporation	Compliance
British Columbia Transit	Compliance
British Columbia Transportation Financing Authority	Qualified
Community Living British Columbia	Compliance
Community Social Services Employers Association	Compliance
Health Employers Association of British Columbia	Compliance
Knowledge Network Corporation	Compliance
Provincial Capital Commission	Compliance
Provincial Rental Housing Corporation	Compliance
Rapid Transit Project 2000 Ltd.	Compliance
Royal British Columbia Museum Corporation	Compliance

3. GOVERNMENT TRANSFERS/ DEFERRED CONTRIBUTIONS

Government's current practice of reporting government transfers, as prescribed by the *Restricted Contributions Regulation*, may lead to a departure from Canadian GAAP.

The shift in accounting practices for reporting government transfers

Historically, transfers of funds or other assets from one level of government to another or from a government to a government organization, designated for a particular area of activity or over future periods, were deferred and matched with the related expenditures of the recipient as they occurred. For example, when a government organization received funds for the purchase of a capital asset, the funds were recognized as revenue to offset or match the expense recognized with the use of the asset ("amortization").

This accounting practice allows governments and their organizations to defer recording a revenue until the period when the related expense is recorded, thus offsetting the expense so that the impact on net income is zero. This approach significantly reduces the volatility in the reporting of income, consequently making managing the "bottom line" on an annual basis much easier, and hence appeals to governments.

In recent years, however, accounting standards have been changing. Instead of matching related revenues and expenditures, the move is to defining income in terms of change in financial position from one period to the next. This new approach is a far more comprehensive means of measuring performance, reflecting transactions occurring over the short term as well as risks being managed over the longer term. In this way, readers of the financial statements can get a better sense of whether the entity's financial position has improved or deteriorated between periods.

As an example, until only a few years ago, investments were recorded at historical cost, in part, so that changes in investment values did not result in volatility in the reporting of income. Our Office observed that, with the change to recording investments at fair value in financial statements, accountability for investment management improved significantly. Boards of directors became more involved in monitoring performance and overseeing the management of risks associated with investments as those risks now had an impact on externally reported financial results – a key measure of their performance.

In December 2010, the Public Sector Accounting Board (PSAB) approved a final standard to replace the existing accounting standard for government transfers. The new standard addresses how a transferring government should account for funding provided or how a receiving government should account for funding received. The mandatory adoption date of this standard was April 1, 2012. The revised standard recommends that transfers be accounted for as revenue in the period in which they are received, unless there are stipulations attached to the transfer that create a liability.[10]

Government's choice not to adopt new accounting standard

Under public sector accounting standards (PSAS), accounting for government transfers differs significantly from historical practices unless an organization applies the optional not-for-profit provisions available within PSAS.

Last year we noted that the Province had directed government not-for-profit organizations to apply PSAS but without the option of using the not-for-profit provisions that would have permitted deferring restricted contributions (as before).

We had therefore expected the Province's accounting for government transfers to change significantly to comply with PSAS.

However, in the fall of 2011, government issued a regulation (B.C. Reg. 198/2011) directing government organizations reporting under PSAS to continue reporting government transfers as they had in the past; that is, permitting the deferral of restricted contributions, even for those contributions that do not meet the liability definition under PSAS.

While we acknowledge that the old framework of reporting government transfers has some theoretical merit and has been adopted by many Canadian jurisdictions in the past, this approach is no longer consistent with GAAP, in Canada or internationally, which does not allow for deferral of contributions in the financial statements unless them meet some strict definitional test of a liability. Most transfers that have been historically deferred in the British Columbia public sector may have to be reported as revenues in the period received to be compliant with GAAP.

10 If there is a liability, the transfer revenue can be deferred. For example, if the transferor specified the purpose for which the funds were to be used, and stated they had to be repaid if not used in that manner, then any unused funds at the end of year would be recorded as deferred revenue. This means that the stipulation of the transfer alone (or the stipulation of the transfer taken together with the actions and communications of the Province before the Summary Financial Statements date) could create an obligation that meets the definition of a liability. Thus, each transfer from the federal government and others will need to be assessed to determine if a liability has been created that will allow unused funds to be deferred.

Our concern

Our Office has requested written analysis to support government's accounting position for government transfers. Our first request was over a year ago. We have not yet received it.

When government issued the deferred contributions regulation, they did so without consulting us. Setting accounting policy without any consultation with the independent auditor is very unusual and concerning.

After issuing the deferred contributions regulation, government has consistently expressed the view that the accounting direction provided is an acceptable interpretation of PSAS. However, we and other auditors of government organizations in British Columbia do not consider the regulation to be an acceptable interpretation of the standards, and in our view it actually modifies them (For a discussion of how changing standards will impact government, see James and Johnson.)[11]

We have therefore concluded that when government organizations defer contributions in contrary practice to PSAS, they are not complying with GAAP. As a result, many of those organizations may receive a non-GAAP compliance or a modified (qualified) audit opinion.

Modification of GAAP results in a significant reduction in the objectivity of financial reporting. Instead of using a standard measuring stick to measure financial performance, government is now determining how performance should be measured and reported to the public.

4. RATE-REGULATED ACCOUNTING

Rate regulation is a restriction on the setting of prices that can be charged to customers for services or products. For example, regulators often specify that certain current costs of a regulated entity must not be recovered from current rates but instead deferred and recovered from customers through future rates in future periods.

Rate-regulated accounting practices were developed to recognize the unique nature of regulated entities and these types of transactions, but they are not currently recognized under Canadian GAAP. However, the International Accounting Standards Board (IASB) is currently reviewing the practice of rate-regulated accounting to determine whether it is appropriate under international financial reporting standards.

Last year we noted the uncertainty as to whether or not international financial reporting standards would allow the use of rate-regulated accounting by organizations such as BC Hydro. Although Canadian Accounting Standards Board allowed BC Hydro to use rate-regulated accounting until March 31, 2012, this provision was made in anticipation of the IASB reaching consensus as to whether the practice was appropriate. Those deliberations continue, however, and the Canadian Institute of Chartered Accountants (CICA) decided to extend the provision until March 31, 2014.

11 See discussion by CJ James, CA and Archie Johnson, FCA, CA-CIA, in "Changing Accounting Framework for Government Organizations." *Beyond Numbers* (September 2012), pp. 14:16

We also noted last year that the government had directed BC Hydro (through B.C. Regulation 257/2010) to use U.S. accounting standard FAS980 Regulated Operations, regardless of the final outcome of the IASB deliberations. B.C. Regulation 257/2010 includes an important exception to applying the U.S. standard. Under FAS980, in order to use rate-regulated accounting, the regulator must be independent of those being regulated. Under the B.C. regulation, however, the requirement that rates be established by or subject to approval by an independent, third-party regulator is not adopted.

We remain concerned that government is willing to override due process in the setting of Canadian accounting standards, legislating an accounting result that has a significant impact on the financial statements of BC Hydro and the Province's Summary Financial Statements. BC Hydro's use of rate-regulated accounting has resulted in a net total of $2.5 billion in expenses being deferred as of March 31, 2012 – a sum that by government's own estimate is expected to grow to $5 billion by 2017.

We are uncomfortable with the inclusion of any rate-regulated assets (or liabilities) in the Summary Financial Statement, but as PSAB allows GBEs to be consolidated without adjusting their accounting policies, we have accepted their inclusion for now. However, if the final outcome of the IASB deliberation is that rate-regulated assets do not meet the definition of bona fide assets under GAAP, then the Auditor General will need to consider the impact of government applying the regulation in the audit opinions of BC Hydro and the Summary Financial Statements.

5. UNCORRECTED ERRORS OUTSTANDING

It is important for an auditor to track the amount of error found in the financial statements because this will affect whether or not the auditor can provide an unqualified audit opinion. The number and type of errors found can also indicate how well management's financial statement preparation processes are working.

In the course of completing our audit of the Summary Financial Statements for 2011/12, we discovered 93 errors in total. Exhibit 4 provides an overview of the errors found and government's response to them since last being identified. We also made four qualifications resulting from uncorrected errors.

Exhibit 4: Errors in the 2011/12 Summary Financial Statements

		Government's response			
		Agrees			
	Errors	Corrected	Uncorrected	Disagrees	Audit Qualifications
Monetary errors	48	18	18	12	2
Disclosure errors	28	17	4	7	1
Reported by auditors of government organizations*	17		17		1
Total	**93**	**35**	**39**	**19**	**4**

* Some of the uncorrected errors reported by auditors of government organizations may be a result of disagreements with auditors' findings.

We would expect government to want to adjust all the errors, unless it disagrees with our proposed correction.

Apart from the four issues that caused us to qualify our audit opinion (as discussed in section "Audit Qualifications", pages 19-24), we did not consider that any other individual uncorrected errors, or the sum of them all, to be significant enough to result in a qualification this year.

In making that determination, we also considered 10 opinions issued to government organizations that were not following, in all respects, the same financial reporting framework used by the government for the Summary Financial Statements. These opinions stated that the organizations' financial statements had been prepared in accordance with section 23.1 of the *Budget Transparency and Accountability Act* for certain specific transactions, and were therefore not in accordance with Canadian public sector accounting standards. We determined, however, that the impact of those specific transactions on the Summary Financial Statements was not significant.

6. WORKING CAPITAL MANAGEMENT

We continue to express concerns related to government's management of working capital. Our Office first brought this issue to government's attention in our 2010 report, *Aspects of Financial Management*, in which we pointed to an excess of working capital in school districts and colleges, and government transfers made in advance of recipient need. These concerns were reiterated in our 2011 report, *Observations on Financial Reporting: Summary Financial Statements 2010/11*.

However, government has made little progress in addressing these issues. As of March 31, 2012, the school districts, colleges and university sector showed significant increases in their working capital. School districts had a balance of $1,012 million (2011: $859 million). This was a $153 million increase over the prior year and an increase of $8 million over the March 31, 2009, balance when we first recommended that government address the issue. School districts are piloting a central depositing system to give them credit, but progress has been slow, with only $25 million on deposit as of March 31, 2012.

Colleges and universities had a balance of $728 million (2011: $687 million).

Such excess reflects poor financial management and reduces the government's ability to effectively reduce its borrowing requirements and the cost of servicing debt. Based on an average annual interest rate of 4.51% on government debt outstanding, and assuming a 2.00% annual return on the working capital balance, the net cost to the provincial government is approximately 2.51% to maintain a working capital balance. This amounts to $25,100 annually for every $1 million in working capital. For the school districts alone, this adds up to about $25 million annually – the budget of a small school district.

7. DISCLOSURE OF CAPITAL LEASE OBLIGATIONS

The total capital lease obligations of the Province were $184 million in 2011/12. We noted, however, that government was providing details about only one of the leases, that with PHH Vehicle Management Services Inc. The current obligation for this lease was $11 million, or 6% of the total.

Government's disclosure of its capital lease obligations has not always been fully presented in the notes of the Summary Financial Statements. Instead, a link to a website is sometimes provided.

Although we asked government before to provide information directly in the notes to the statements rather than the link, government declined. It felt that including the information in the statements would be excessive detail for the notes, and that providing redirection to entity financial statements through the website would be sufficient.

We recognize that it is impractical to provide details of all leases throughout the reporting entity, but we pointed out that government needed only to provide details from three additional specific leases and they would have covered almost 90% of the total obligation.

There are 140 organizations in the reporting entity. Only the most dedicated reader would search through that number of financial statements to find information about the capital lease obligations.

In our view, providing a website reference under such circumstances is an inadequate substitute for proper disclosure.

8. CHANGE IN OPERATIONS OF THE PROVINCIAL CAPITAL COMMISSION

During 2012, the Provincial Capital Commission was restructured so it could focus on outreach programs. As a result, the commission ceased to be accounted for as a self-supported Crown corporation and was instead fully consolidated.

Canadian public sector accounting standards require that the fact of this change, the reasons for it and the financial effect should be disclosed. However, only the first of those (the fact of this change) has been disclosed. A footnote on page 85 of the Summary Financial Statements says "during the fiscal year, this organization was changed from a self-supported to a taxpayer-supported Crown corporation."

We point out that the impact of this change on the Summary Financial Statements in 2012 has been to fully consolidate the entity on a line-by-line basis. This means that each of the commission's assets, liabilities, revenues and expenditures is included separately, not just the net investment.

As a result:

- cash has increased by $2 million;
- deferred revenue has increased by $3 million;
- tangible capital assets have increased by $22 million;
- miscellaneous revenue has increased by $5 million; and
- other expenses have increased by $3 million.

As well, the equity in self-supported Crown corporations and agencies has been reduced by $15 million. This is apparent from note 7, where the equity in the Provincial Capital Commission for 2010/11 is $15 million, and in 2011/12 it was nil. But this change is not shown separately in the second half of note 7, Change in Equity in Self-supported Crown Corporations and Agencies. Instead, it is included with the amount of the prior period adjustments.

Apart from not being shown separately, this presentation is wrong in two ways:

- First, the adjustment of the $15 million is not a prior period adjustment. The Provincial Capital Commission changed to a taxpayer-supported Crown corporation during the current year, not the prior year.
- Second, the adjustment means that the balance of equity in self-supported Crown corporations and agencies at the beginning of the year – as restated and shown as $6,680 million – does not equal the balance at the end of the previous year, shown as $6,695 million. Those two figures (the opening balance for this year and the ending balance for last year) should be the same.

APPENDIX 1: RESPONSE FROM GOVERNMENT

I appreciate the opportunity to respond to the Office of the Auditor General's comments and as discussed in our meeting the government remains committed to providing meaningful financial statements. To this end, I continue to report the financial statements in accordance with public sector generally accepted accounting principles (GAAP), which are those accounting policies and applications that have been generally accepted by a majority of senior governments in Canada. My key objectives in preparing the Public Accounts is to:

- Provide the right level of information to help users understand the current financial position of the province, and the government's annual operating results;
- Report consistently so that users can easily compare results between years; and
- Select accounting policies and apply accounting standards as consistently as possible with other jurisdictions in Canada.

I believe general purpose financial statements must serve the needs of a broad base of stakeholders. To achieve that they have to present the right level of information to provide a "summary" view of the financial effect of the wide range of programs delivered by the broader public sector including not only government, but also crown agencies including Schools, Universities, Colleges, and Health Authorities. The organizations that establish accounting standards for the public sector have the difficult job of determining how to do that while still achieving some core objectives including timeliness, representational faithfulness, and continuity over a long period of time.

The changes in accounting standards have been dramatic over the past decade and there is still much work to do to absorb those changes not only into financial reporting but into the basic governance and management structures that are necessarily affected by changes in accounting standards. Getting all of the preparers and auditors across jurisdictions to understand and adopt standards in the same way is difficult and usually takes time as the principles are applied to unique transactions and circumstances.

Changes in accounting standards are inevitable and should only be undertaken after due process resulting in a generally accepted application across jurisdictions. My approach is to work actively with standard setters and other jurisdictions to understand how changes relate to historical practice, to identify conflicts that indicate problems either with past practice or new guidance, and to plan for implementation so that financial statements are reported on the same basis. I take this conservative approach because the risk of taking an accounting approach that is later changed would undermine the long term usefulness of financial reporting. Financial information is most useful if it is conceptually consistent over a long period of time so that users can meaningfully compare the current year to prior years and estimates of future years.

RESERVATION OF OPINION

1. Basis of Consolidation of the Transportation Investment Corporation

I believe that the Transportation Investment Corporation is best disclosed as a government business enterprise (GBE) under the modified equity basis of consolidation. The defining element of a GBE is that it is able to maintain its own operations from revenues raised outside the government reporting entity. Unlike taxpayer supported organizations, GBE's do not receive subsidies from their parent governments. An organization does not have to be profitable to be self-supporting. We both agree that the Transportation Investment Corporation will support its operations from toll revenue over the life of the program, but have a difference of opinion about when the organization should be reported as a GBE.

Because government's stated policy has been to fund the project through user tolls, and objective evidence indicates tolls will fully fund the project, I do not believe it would be correct to disclose the Transportation Investment Corporation as a taxpayer supported entity, then change the disclosure to a self supported entity at an arbitrary point when annual revenues exceed annual expenses on the accrual basis.

2. Provision for Natural Gas Producer Credits

Regulation provides for an allowable deduction on the royalties payable if the eligibility criteria is met. In the case of Deep Well credits, the deduction is calculated based on the depth of the well and can be calculated when the well is drilled, even though the royalties will be payable only when the well produces, which could be in future accounting periods. Because the deduction is only relevant in the calculation of royalties attributable to a specific well when they occur, there is no amount payable to the producer at the financial statement date.

Recording an amount payable related to the costs incurred by the producer would not be appropriate because the costs are not refundable; the only provision is for a deduction in the calculation of future royalty revenues. Recording a liability for allowable deductions arising from deep wells would require an expense to be recorded in the current fiscal year and result in inflated revenues recorded in a subsequent fiscal year. This treatment would not represent the economic substance of the transaction because deductions are an integral part of the royalty which are only recognizable as revenue when the well produces, not when the well is drilled .

The Public Sector Accounting Board (PSAB) has undertaken a project to review accounting guidance for revenue from exchange transactions. I have requested that this issue be addressed in the same way that recent guidance on the treatment of taxation revenue deals with allowable deductions in the calculation of tax. I do not believe that there is any conceptual basis for different treatment, and expect the PSAB to confirm the existing treatment followed by all jurisdictions in Canada.

3. Deferral of Government Transfers Revenue

Governments traditionally fund the capital requirements of public sector entities through grants that are restricted for a specific purpose such as the construction of a school, hospital or highway. Those contributions have historically been recorded as a liability rather than revenue when received because it best represents the ongoing obligation of the recipient to deliver the service to taxpayers for the useful life of the asset. The benefit of that treatment is that the recipient acquires low cost funding from government, government fulfills its duty to ensure taxpayer funding achieves the intended outcomes, and financial statement users are informed about the ongoing financial obligation to keep schools, hospitals or highways maintained and in service over their useful life.

A challenge identified by the Auditor General is that historical transfer agreements do not always include the specific terms of restriction that revised guidance in the area of government transfers contemplates. At this time there is a broad divergence of opinion within the accounting community across jurisdictions in Canada. The issue is whether the substance of funding arrangements should be the determining factor, or whether the form of historical agreements should solely determine the economic substance of transfer arrangements. In Canada both private and public sector accounting guidance requires that accounting be based on the substance of transactions rather than their legal form.

While addressing this issue I have to be mindful of how other jurisdictions are applying this same guidance to the same federal transfers that BCTFA is currently deferring. Failing to work with other jurisdictions would compromise our credibility of the national public sector accounting standards. To address this transitional issue I will work collaboratively with the Office of the Auditor General to engage our colleagues across jurisdictions to achieve a consistent application under Canadian public sector accounting standards.

4. Disclosure of subsidiary government business enterprises

I agree with the Auditor General that there is an inconsistency in the treatment of commercial subsidiaries of government versus the treatment of commercial subsidiaries of consolidated entities like Universities. This is an area where once again British Columbia is the first to address a new area in public sector accounting and provides an opportunity to work collaboratively with the Office of the Auditor General in providing national leadership in emerging areas of accounting. While accounting standards do not currently provide guidance on this issue I believe a more consistent approach would benefit financial statement users and will work with the Office of the Auditor General to determine the best approach to achieving consistency.

Other Recommendations to Government

Accounting Standards

I agree that a national accounting standard for the public sector is important to the credibility of government financial statements. In his audit opinion the Auditor General agrees that the accounting policies used in the preparation of the Summary Financial Statements are consistent with Canadian Generally Accepted Accounting Principles.

As noted in the report there are currently two regulations under the BTAA that are required to address gaps in Canadian public sector accounting standards or their application during transition.

- BC Regulation 257/20 I 0 retains the pre-existing Canadian guidance on rate regulated accounting and is required because the International Accounting Standards Board has not yet decided how to address rate regulated accounting, and Canadian standard setting bodies have not provided interim direction. The regulation is consistent with the guidance of the Canadian Securities Administrators Association, and the Canadian Accounting Standards Board.

- Be Regulation 198/2011 clarifies the requirement to defer contributions where appropriate stipulations are in place and is required to ensure consistency between the financial reporting of crown agencies and the legislative and regulatory requirements governing transfers from government to those entities. The regulation is consistent with Canadian public sector accounting standards guidance on government transfers and liabilities.

Financial statement discussion and analysis

The Office of the Comptroller General currently fulfills all of the stated recommendations of GAAP in disclosing relevant information about the government's exposure to potential risks and their financial impacts in the Financial Statement Discussion and Analysis (FSDA) section of the Public Accounts. Where opportunity exists to improve the information or presentation of the FSDA I will work with the Office of the Auditor General to examine those opportunities.

Accountability frameworks

The preparation of the Summary Financial Statements is not affected by the fiscal policy choices of government. Accounting standards do not provide direction on policy choices because the role of accounting is to be objective and unbiased in the presentation of the financial performance and position of government. As with any budget management mechanism, the administration of balanced budget targets, including any changes or amendments, requires open discussion and debate in the legislature by the direct representatives of taxpayers. There is no process that provides clearer transparency and accountability.

Balanced budget legislation was introduced in 2001 as a commitment to taxpayers that government would not spend more money than it took in. That commitment has helped in achieving seven successive credit rating increases since 2004. The province currently has a triple-A credit rating, the highest rating possible and something few jurisdictions enjoy. The high credit rating saves taxpayers millions of dollars each year in government borrowing costs. Those savings can be invested in public services, or debt reduction.

Management Letters

The organizations that receive management letters work with their auditors to address any reported findings. Although the specific management letter findings only relate to individual organizations, they may identify issues that are important to all government organizations. The issues are reviewed from a government reporting entity perspective as part of our ongoing effort to improve financial management and governance practices across all organizations that are included in the Summary Financial Statements. Each year the Office of the Comptroller General works with ministries and Crown agencies across the government reporting entity to resolve audit issues and identify systemic improvements to the financial management and reporting process identified during the year-end audit process.

I believe the 2011/12 Public Accounts once again demonstrate government's commitment to transparent and accountable financial reporting that meets the information needs of our users. I thank the Office of the Auditor General for its continuing support in meeting this objective.

Stuart Newton
Comptroller General
Province of British Columbia
November 13, 2012

APPENDIX 2: MANAGEMENT LETTER ISSUES RAISED IN 2011/12

The audit of the Summary Financial Statements is the largest audit in British Columbia. From July 2011 to June 2012, staff and contractors from our Office and from many private sector accounting firms audited the financial statements of all government entities that are included in the government reporting entity. In planning and performing each audit, consideration is given to an entity's governance and accountability, and internal control over areas such as financial management, disclosure, and information technology.

We expect management to have appropriate controls to prevent errors in financial reporting, that is there should be no issues. When a control is found to be inadequate it is brought to management's attention with the auditor's recommendation, referred to as a management letter. (A standard of the Canadian Institute of Chartered Accountants is that significant findings be communicated by the auditor to management).

It is management's responsibility to weigh the costs of implementing recommended control improvements against the benefits that will be achieved, and to implement those recommendations it considers beneficial.

The findings presented in management letters are significant and should be considered by management as soon as possible.

Our Office expects management letters to be issued to all government organizations in the government reporting entity (164 entities, made up of 148 government entities plus 16 ministries), as well as the Office of the Comptroller General. Therefore, the total number of management letters expected to be issued for 2011/12 is 165. Of those, 152 (92%) had been issued at the time of writing this report (Exhibit A2.1).

The percentage of management letters issued is slowly improving. When we first began measuring this information for the 2007/08 Summary Financial Statements, the percentage issued was a little lower, at 88%.

Exhibit A2.1: Number of management letters issued during 2010/11 and 2011/12

	2010/11		2011/12	
Management letters issued	150	92%	152	92%
Management letters not issued at the time of this report	13	8%	13	8%
Total	**163**	**100%**	**165**	**100%**

It is a generally accepted practice for auditors to present their management letter findings to the audit committee, with management present. It is also common for management to provide a written response to the management letter points. In this way, the audit committee has an opportunity to understand the issue from the perspective of both the auditors and management, and is informed of the actions management will take as a result of the management letter.

MANAGEMENT LETTER ISSUES RAISED IN 2011/12

The 152 management letters issued to date for the 2011/12 fiscal year include a total of 463 issues and recommendations. Of the 463 issues, 211 pertain to new control concerns identified in the current year's audit, while the remaining 252 (54%) issues pertain to items identified in prior year audits that were not addressed (or were only partially addressed) by management during the current fiscal year.

Last year, we noted that of the 387 issues identified, 170 (44%) of the issues pertained to items that had not been addressed.

It continues to concern us that management has not resolved so many issues brought forward by their auditors, especially as the unresolved points are growing in number.

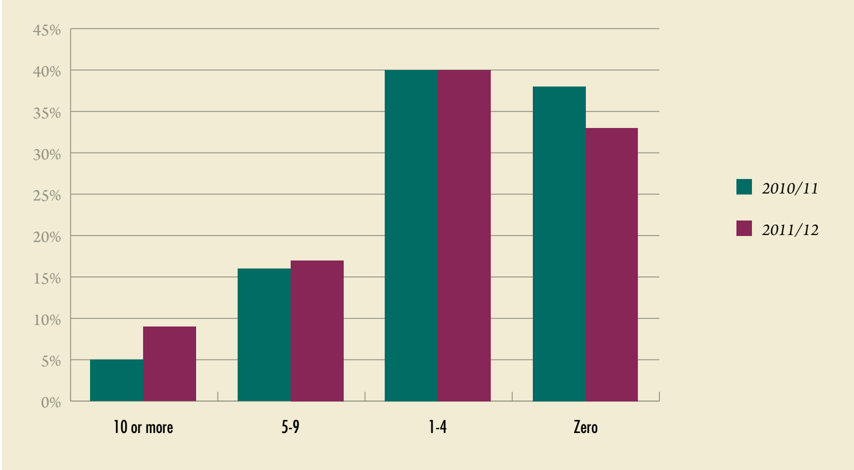
The management letters issued focus mainly on improving the areas of governance and accountability, financial management and disclosure, and information technology. We found that 112 (74%) of the 152 management letters issued contain fewer than five issues, including 50 (33%) letters where the auditors found no issues to be reported at all.

In comparison with last year, fewer entities had no issues reported. Of the remaining 40 (26%) letters, 14 had 10 or more issues, whereas 2010/11 saw only eight entities having 10 or more issues (Exhibit A2.2 and A2.3).

Exhibit A2.2: Number of issues in each management letter, 2010/11 and 2011/12

	2010/11	2011/12
Number of government entities with		
10 or more management letter issues	8	14
5 to 9 management letter issues	24	26
1 to 4 management letter issues	61	62
No management letter issues	57	50
Total number of management letters issued	**150**	**152**

Exhibit A2.3: Number of issues identified in management letters (by % of total letters provided)



Of the 463 outstanding issues identified for this year, 211 are new. Exhibit A2.4 provides a breakdown of the 211 new issues, by government sector and by whether the issues were from audits performed by the Office of the Auditor General or by other audit firms.

Exhibit A2.4: Number of new issues reported during 2011/12, by sector and by auditor

	Office of the Auditor General		Other audit firms		Total	
Sector	# of Audits	New Issues	# of Audits	New Issues	# of Audits	New Issues
Consolidated Revenue Fund	17	20	0	0	17	20
Health	1	1	18	7	19	8
Education	8	43	83	85	91	128
Natural Resources and Economic Development	7	10	6	3	13	13
Transportation	4	12	1	0	5	12
Social Services	0	0	2	5	2	5
Other	1	9	12	8	13	17
Protection of Persons and Property	1	0	2	2	3	2
General Government	1	0	1	6	2	6
Total	**40**	**95**	**125**	**116**	**165**	**211**

The Office continues to focus on audits deemed to be higher risk. During 2011/12, our Office performed 40 audits and found 95 new management letter issues while audit firms performed 125 audits and found 116 new issues.

In 2010/11, these figures were 84 new issues from 44 audits done by our Office and 133 new issues from 119 audits done by firms. The Office and other firms continue to find new issues with management's controls year over year.

CONTROL CONCERNS RAISED IN MANAGEMENT LETTERS IN 2011/12

In last year's report, we disclosed the 13 themes of control concern that arose most often in government entities' management letters. In reviewing and preparing this year's report, we found no new instances of a lack of appropriately disclosed accounting policies. Hence there are 12 themes of control concern for this year. No other new themes were identified.

Exhibit A2.5 lists the control concerns we have identified this year. These themes identify the most common control concerns noted in government entities' management letters.

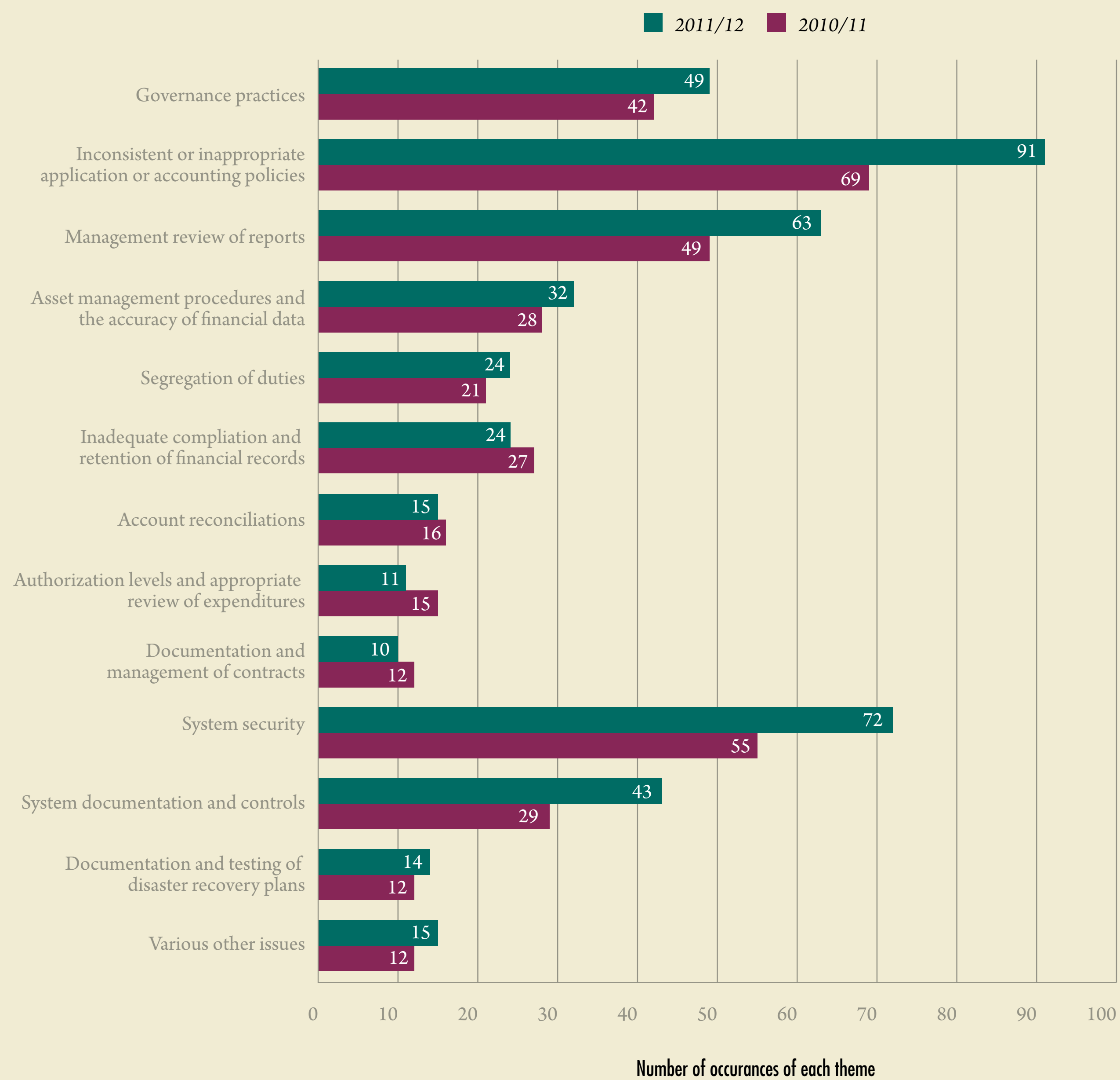
Exhibit A2.5: Control concerns identified by our Office in 2011/12

Area	2011/12 management letter themes
Governance and Accountability	Governance practices
Financial Management and Disclosure	Inconsistent or inappropriate application of accounting policies
	Management review of reports
	Asset management procedures and the accuracy of financial data
	Segregation of duties
	Inadequate compilation and retention of financial records
	Account reconciliations
	Authorization levels and appropriate review of expenditures
	Documentation and management of contracts
Information Technology	System security
	System documentation and controls
	Documentation and testing of disaster recovery plans

The audit process is not intended to disclose issues outside the financial statement process. Each organization must therefore be vigilant in conducting its own review of possible issues, such as those related to our report themes of financial management and disclosure, governance and accountability, and information technology.

Exhibit A2.6 shows the number of times each theme arose in the management letters.

Exhibit A2.6: Frequency of management letter themes, 2010/11 and 2011/12



To help organizations identify potential risk areas, we summarize below all major findings from the audits, highlighting those concerns that arose most often and have the greatest potential risk and impact. All government entities should examine these findings with a focus on improving their own controls.

The following section presents summaries of the prevalent themes raised in the management letters that provincial government entities received during 2011/12.

Governance and accountability findings in 2011/12

Governance practices

Governance refers to the structures and processes by which organizations are directed, controlled and held to account. These are supported by guiding core principles of accountability, leadership, integrity, stewardship and transparency. Strong governance practices provide clear and ethical direction, anticipate risk, communicate effectively, and give and receive feedback on performance.

To operate effectively and efficiently, government entities need to have an independent functioning board of directors (or equivalent) to implement correct and complete policies, procedures and controls, and ensure that the entity adheres to them. Clearly defined roles and responsibilities must also exist and be understood.

We found 49 instances of inadequate governance practices. Of these, 28 were unresolved from prior years. Several issues are limiting the ability of some government entities to govern effectively. These include:

- policies that are not being reinforced or are missing;
- incomplete oversight;
- unclear roles and responsibilities; and
- lack of communication.

Additionally, we continue to notice in some areas a lack of policy for managing cash held by organizations to maximize return.

Weak governance is at the heart of many public sector failures and may lead to the loss of public trust.

Financial management and disclosure findings in 2011/12

Inconsistent or inappropriate application of accounting policies

Government entities are required to follow a set of policies that dictate how information is accounted for and presented in each entity's individual set of financial statements and in the consolidated financial statements of the government reporting entity as a whole. Accounting policies are set by each individual organization, but must adhere to Canadian generally accepted accounting principles (GAAP), the framework for the financial reporting process in Canada. The application of consistent and appropriate accounting policies helps guide an organization in its financial reporting process and ensures that the entity is adhering to GAAP.

All recommendations provided to the entities relating to deficient accounting policies need to be understood and addressed in a timely manner to ensure that financial information is complete and accurately reported in the Summary Financial Statements.

We found 91 instances of inconsistent or inappropriate applications of accounting policies. Of these instances, 33 were unresolved from prior years. The most common issues reported related to the capitalization of expenditures, amortization of fixed assets, revenue and expense recognition, and revenue and expense classification.

Inappropriate application of accounting policies can result in incomplete or inaccurate financial reporting in the Summary Financial Statements.

Management review of reports

Internal reports are generated to inform management of operations and help identify errors and inconsistencies. Strong policies and procedures over internal reports include review and sign-off by the appropriate personnel.

Government entities need to ensure that correct and timely report review practices are undertaken, and that report findings and recommendations are acted on in a timely manner.

We found 63 instances where management's reviews of reports were inadequate. Forty of these issues were unresolved from prior years. The most common themes were the lack of management review over internal reports and the deficient design of the internal report or the procedures surrounding it.

Inadequate management review of reports creates the potential for inefficiencies, errors and fraud.

Asset management procedures and the accuracy of financial data

Strong asset management procedures help maintain an organization's level of proficiency in using its assets to meet its operational needs. Strong asset management procedures facilitate efficient use and safeguarding of organizational assets and support accurate and complete financial reporting for these assets. An organization's operational assets include inventory and capital assets. Strong control over these assets requires strict policies and procedures over ordering, warehousing, safeguarding, and financial measurement for reporting purposes.

Government entities need to ensure that adequate policies and procedures are in place to effectively manage their organizational assets.

We found 32 instances where asset management procedures were inadequate and financial data was inaccurate. Seventeen of these issues were unresolved from prior years. These control concerns primarily surrounded inventory counting, capital asset management and purchasing controls. In addition, we noted issues with respect to controls over cash and cheques held on site at organizations.

Without strong asset management procedures, there is a risk that the results presented by the organization could contain errors or omissions and not present the true picture of the organization.

Segregation of duties

A key operational control is segregation of duties, which is accomplished by having critical functions performed independently of one another. Ideally, different individuals should be assigned responsibility for each critical function in each financial process to ensure that functions are performed independently of one another.

Government entities should adopt appropriate policies for the segregation of duties, where applicable, to reduce the risk of fraud and error.

We found 24 instances of issues related to segregation of duties. Of these, 13 were unresolved from prior years. The most common issues reported related to one individual initiating and approving entries to the financial system and one individual being responsible for preparing and approving bank reconciliations. Other issues pertained to the handling of cash receipts, payroll entries and purchasing.

Without proper segregation of incompatible functions, individuals could subvert management controls and create a fraud.

Inadequate compilation and retention of financial records

Government organizations implement various policies and procedures to ensure that financial records are complete and properly retained to create an audit trail of the organizations' operations. The compilation and retention of these financial records is an important control that provides evidence to verify the effective day-to-day operations of the entities.

Government entities should ensure they have good financial record-keeping that will help improve efficiencies and reduce errors.

We found 24 instances of inadequate compilation and retention of financial records. Of these, 19 were unresolved from prior years. These occurrences were generally the result of poor or untimely record-keeping, which can make review of transactions difficult and possibly lead to errors or fraud

Inadequate financial records can result in ineffective operations and poor financial management.

Account reconciliations

Organizations perform account reconciliations to ensure their transaction recording is complete and accurate.

Government entities should ensure that reconciliations are in place for key operational and financial accounts. The reconciliations need to be adequately structured, performed on a regular basis and reviewed by an appropriate level of management.

We found 15 instances of account reconciliation issues. Ten of these were unresolved from prior years. These issues include:

- a lack of reconciliations over accounts;
- incomplete reconciliations;
- a lack of timely reconciliations; and
- a lack of follow-up procedures for identified accounts.

Without a good reconciliation process, an entity may be susceptible to errors in financial accounts. This can lead to improper representation of operating performance, as well as errors in budgeting and potential for fraud.

Authorization levels and appropriate review of expenditures

Government entities implement policies and procedures to ensure that adequate control exists over the purchasing of goods and services. Having a robust process to review expenditure is a control that can help prevent unauthorized purchases and payments.

Government entities need to ensure that there are appropriate levels of expenditure authorization in place, and that those levels are consistently observed.

We found 11 instances where transactions were approved or initiated by someone who did not have the appropriate authority to do so. Seven of these issues were unresolved from prior years. The key issues were:

- not adhering to expenditure authorization levels;
- not adhering to signing authority levels;
- payments being made without proper authorization levels; and
- inappropriate documentation.

Not following proper authorization for expenditures means there is a greater possibility of unauthorized purchasing, overspending and fraud.

Documentation and management of contracts

A government entity establishes contracts with outside parties in order to provide or receive specific services related to its day-to-day business activities.

Government entities should ensure that adequate documentation and controls are in place when a contractual relationship exists between an entity and outside parties.

We found 10 instances of poor documentation and inadequate management of contracts. Six of these issues were unresolved from prior years. These issues include:

- absence of formal finalized contracts;
- lack of review of significant contracts to ensure accuracy and adherence to terms; and
- outdated, unclear and incomplete contract documentation.

In addition to contracts executed with outside parties, we noted that internal contracts with employees were incomplete or missing or contained terms that required clarification.

In the absence of complete and specific contract documentation, discrepancies can arise in the interpretation of terms within the agreement. These discrepancies can hinder business relationships, cause inefficiencies in the overall business operations of government and lead to legal disputes.

Information technology (IT) findings in 2011/12

In last year's report we disclosed three areas of control concern related to Information Technology, grouped by specific theme (see Exhibit A2.7).

Due to the continued persistence, significance and pressing need for action to address these issues, each of these were reviewed more closely earlier this year in an IT Summary Report for 2010/11.

Going forward, we plan to continue to publish IT-related findings from the audit of the Summary Financial Statements as a separate report. The IT Summary Report for 2011/12 has not been released yet; however, at this time we can report areas of control concern identified last year continue to persist, as indicated in Exhibit A2.6 and Exhibit A2.7:

Exhibit A2.7: Frequency of IT issues, 2010/11 and 2011/12

	Number of management points issued in 2010/11	Number of management points issued in 2011/12
System security	55	72
System documentation and controls	29	43
Documentation and testing of disaster recovery plans	12	14

The IT Summary Report for 2011/12 will discuss these issues in greater detail, and is expected to be released in March 2013.

APPENDIX 3: STATUS OF PRIOR YEARS' RECOMMENDATIONS

In our reports on the 2006/07, 2007/08, 2008/09, 2009/10 and 2010/2011 Public Accounts, we made a total of 62 recommendations, of which 14 were recommendations made in more than one year. Of the 48 different recommendations:

- 12 have been completed or substantially completed;
- 6 we have decided not to pursue at this time in our public report (some are reported to government in our annual management letter to the Comptroller General); and
- 30 are still outstanding.

All outstanding recommendations are listed below. Some of these are made again in this year's report.

Classification of debt

2010/2011 no.1 (p. 25)

> We recommend that government revise its definitions of self-supported and taxpayer-supported debt to better describe the nature of the debt.

2010/2011 no.2 (p. 25)

> We recommend that government include the debt of the warehouse borrowing program with taxpayer-supported debt and not with self-supported debt.

Disclosure of gaming grants

2010/11 no.3 (p. 26)

> We recommend that gaming grants be classified in the statement of operations according to the purpose of the grant provided by government.

Accounting for tax appeals

2010/11 no.4 (p. 26)

> We recommend that government record an estimate of tax appeals that have not yet been assessed as an accrued liability in the Summary Financial Statements. Because the accrual will be based on an estimate, government should also disclose the amount of uncertainty around the estimate in the Measurement Uncertainty note (note 2) to the Summary Financial Statements.

Disclosure of changes in budgets

2010/11 no.5 (p. 27)

> We recommend that when government's planned Estimates are not prepared on a basis consistent with that used to report the actual results, the planned results be restated. As well, a reconciliation should be provided to show the amendments made from the original Estimates to the amounts reported in the Summary Financial Statements.

Transparency and utility of contractual obligation disclosures

2010/11 no.6 (p. 28)

We recommend that government provide more complete disclosure of the anticipated payments to be made after five years so that stakeholders can fully appreciate the duration and timing of these obligations.

2010/11 no.7 (p. 28)

We recommend that government expand its existing supplemental contractual obligation disclosures to ensure that stakeholders have access to information they might find significant. Disclosures should include:

(a) significant terms and conditions of the contracts that could impact expected future cash inflows or outflows and service delivery continuance, key renewal and termination options, and any other rights or obligations that could have a material impact on the contract or on users of that contracted service;

(b) more complete descriptions of the rules used to compile the supplementary contractual obligation disclosure, as well as any significant limitations these rules could impose on the use of the information; and

(c) comparative contractual obligation information to help readers understand trends in government's contractual obligations.

2010/11 no.8 (p. 28)

We recommend that government provide the supplemental contractual obligation disclosure information to the public in a format that is easy to use and that facilitates further stakeholder analysis and evaluation of results.

Complete disclosure of prior year adjustments

2008/09 no.4 (p. 43) and 2009/10 no.1 (p. 23)

We recommend that, when prior year numbers have been restated, government draw attention to the restated numbers with appropriate referencing and make full disclosure of the changes that have taken place, in accordance with Canadian generally accepted accounting principles.

Ministry financial statements

2008/09 no.10 (p. 55) and 2009/10 no.2 (p. 23)

We recommend that government require individual ministries to prepare separate financial statements as well as consolidated financial statements to show the financial results of the sectors they are responsible for.

Accounting for First Nations settlement costs

2008/09 no.1 (p. 35) and 2009/10 no.3 (p. 24)

> We recommend that government again review its accounting policy with respect to the settlement of First Nations transactions to ensure the policy is in accordance with Canadian GAAP.

Accounting for inherited crown land

2007/08 no.7 (p. 45), 2008/09 no.2 (p. 36) and 2009/10 no.4 (p. 25)

> We recommend that when inherited Crown land is valued, the change in value be recorded in accordance with Canadian GAAP as a credit to accumulated surplus/(deficit) and not to revenue.

Classification of debt

2008/09 no.3 (p. 42) and 2009/10 no.5 (p. 26)

> We recommend that the debt of the warehouse borrowing program and of the Transportation Investment Corporation be included with taxpayer-supported debt and not self-supported debt.

Disclosure of contractual obligations

2006/07 no.4 (p. 16), 2007/08 no.10 (p. 47), 2008/09 no.5 (p. 44) and 2009/10 no.6 (p. 26)

> We recommend that government include additional information about the nature of the contractual obligations in the Summary Financial Statements.

2007/08 no.11 (p. 47), 2008/09 no.6 (p. 45) and 2009/10 no.7 (p. 27)

> We recommend that government use a lower cut-off for collecting and assessing the disclosure of contractual obligations in the Summary Financial Statements.

Pension plan disclosures

2009/10 no.8 (p. 27)

> We recommend that government improve its disclosure of pension plans as required by Canadian GAAP.

Direct method of cash flows

2008/09 no.7 (p. 46)

> We recommend that government present its statement of cash flow using the direct method.

Authority to borrow

2008/09 no.8 (p. 51)

We recommend that ministry staff keep an ongoing record of the amounts they are authorized to borrow. Government should consider both providing a mechanism for legislative debate over the amount it intends to borrow, and implementing a mechanism to rescind previous, unused authorities to borrow.

Comparing budget information with the Summary Financial Statements

2008/09 no.9 (p. 54)

We recommend that government improve its Budget and Estimates documents to include full, line-by-line budget information for each of the sectors reported in the Summary Financial Statements, and to include the budget-to-actual information in the Summary Financial Statements. We also recommend that government provide budget information in the financial statements of organizations that make up the Summary Financial Statements.

Separate disclosure of liabilities related to leased tangible capital assets (partially completed)

2006/07 no.9 (p. 26) and 2007/08 no.1 (p. 37)

We recommend that government include liabilities related to leased tangible capital assets as a separate line on the statement of financial position, and include the additional note disclosure as required by Canadian public sector accounting standards.

Oil and natural gas producers' royalty credits

2007/08 no.3 (p. 40)

We recommend that government record royalty revenues on a gross basis as required by Canadian public sector accounting standards.

Provision for deep-well credits

2007/08 no.4 (p. 40)

We recommend that government accrue a liability for the deep-well credits as they are earned by the oil and gas producers, as required by Canadian public sector accounting standards.

Government needs to review accounting for First Nations settlement costs (partially completed)

2006/2007 no.21 (p. 42) and 2007/08 no.6 (p. 44)

We recommend that government review current accounting policy and guidance to ensure it adequately addresses how to measure, and when to recognize, the unique nature of First Nations settlement transactions in the Summary Financial Statements.

Accounting for, and recognition of, inherited Crown land revaluations (partially completed)

2007/08 no.9 (p. 46)

> We recommend that government review their policy to ensure a consistent and appropriate valuation method is used when recognizing inherited Crown lands.

Segmented reporting disclosure (partially completed)

2006/07 no.20 (p. 41) and 2007/08 no.15 (p. 49)

> We recommend that government, in continuing to adopt best disclosure practices, produce detailed sector schedules in the Summary Financial Statements.

Government's financial statement discussion and analysis (partially completed)

2006/07 no.1 (p. 14)

> We continue to recommend that government present a long-term trend analysis in the Financial Statement Discussion and Analysis (FSD&A) so that it can provide better context for discussing government's financial performance. In addition, we recommend that government cross-reference the FSD&A and the Financial and Economic Review.

2006/07 no.2 (p. 14)

> We recommend that government continue to expand its Financial Statement Discussion and Analysis (FSD&A) to better cover material financial risks and uncertainties and the challenges involved in their ongoing management.

2006/07 no.3 (p. 15)

> We recommend that government adopt the use of the CICA-recommended measure of "government-to-government transfers to own-source revenue" for use in the financial statement discussion and analysis.

Disclosure of tangible capital assets under lease (partially completed)

2006/07 no.8 (p. 25)

> We recommend that government create a table for tangible capital assets under lease, similar to the table presentation used for the current statement of tangible capital assets.

Assessment of long-term liabilities and disclosure of material errors

2006/07 no.11 (p. 27)

> We recommend that when government corrects material errors in its financial statements, it also provide a description of the error and the effect of the correction, and that it head the prior period columns on the face of the financial statements "as restated."

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