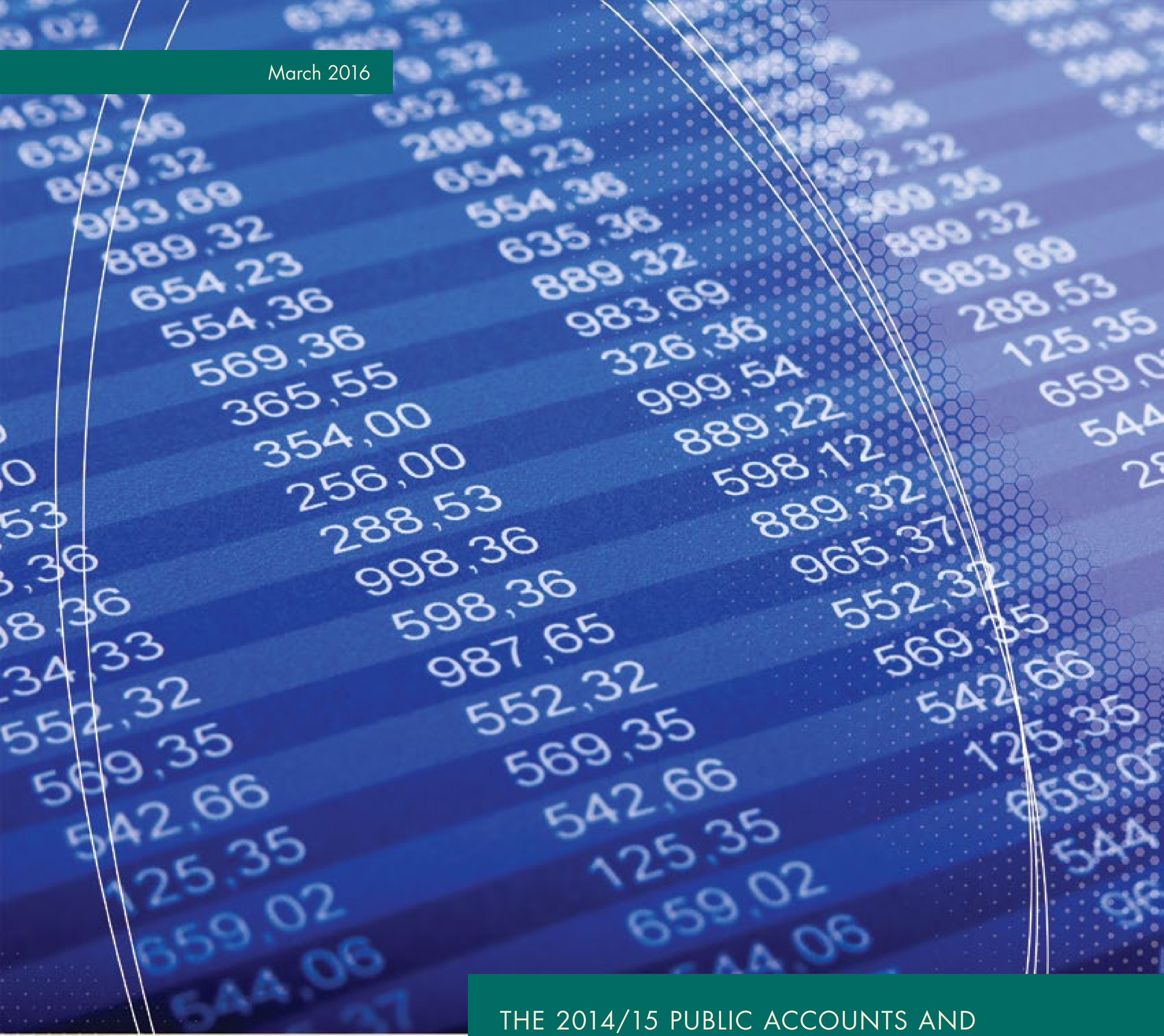
March 2016



THE 2014/15 PUBLIC ACCOUNTS AND THE AUDITOR GENERAL'S FINDINGS

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The Honourable Linda Reid
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
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Dear Madame Speaker:

I have the honour to transmit to the Legislative Assembly of British Columbia my report, *The 2014/15 Public Accounts and the Auditor General's Findings*.

Under section 11(1) of the *Auditor General Act*, my Office is required to report on whether the Provinces' Summary Financial Statements are presented fairly in accordance with Canadian generally accepted accounting principles (GAAP).

This report speaks to the results of our financial audit of the Summary Financial Statements.

Carol Bellringer

Carol Bellringer, FCPA, FCA
Auditor General
Victoria, B.C.
March 2016

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AUDITOR GENERAL'S COMMENTS

Carol Bellringer, FCPA, FCA
Auditor General

My Office is required to report each year on whether the province's Summary Financial Statements are presented fairly in accordance with Canadian public sector accounting standards. This is the largest audit in B.C. and takes 65 staff and contractors in our Office just over 42,000 hours to complete. It also requires assistance above and beyond our work from 25 private-sector auditing firms.

At the end of our audit work, I issue an auditor's report or 'opinion' that is published with the province's Summary Financial Statements. My opinion says whether or not the financial statements present the province's financial position and results for the year fairly, in accordance with Canadian public sector accounting standards.

Government is very large and provides many different types of services in various ways. This can make the financial statements complex and sometimes difficult for readers to interpret and fully understand. But they also include a wealth of information, so we issue this report in part each year to draw attention to a few of the interesting stories.

We also provide additional information in this report about our audit work and explain the nature of my audit opinion. It is important to note that for the 2014/15 Summary Financial Statements, I concluded that government should have recorded an additional $191 million in revenue in 2014/15, and should have recorded just over $4 billion in revenue in prior years.

Why should this matter? In fact, you may ask, when B.C. reported a surplus in 2014/15 of almost $1.7 billion, and an accumulated surplus of almost $3.3 billion, why should I be concerned the Auditor General is telling me it should be an even greater surplus? For one, deferring the revenue means that government is not recording revenue in these good years. When that revenue is eventually recorded, maybe in years when

AUDITOR GENERAL'S COMMENTS

financial results could otherwise be less favourable, it may cloud the true financial health of the province. For another, the answer lies in the importance of generally accepted accounting standards.

Canada is fortunate to have strong, independently-set public sector accounting standards that are generally accepted by the federal, provincial and municipal governments. Financial statements prepared on the same basis are more easily compared and understood. When they are not prepared in accordance with those accounting standards, it is important to know the impacts.

In addition to further explaining our audit work, this report includes links to some important and useful information about the financial health of our province. For example: *How much did government spend on health? What is B.C.'s total debt?* We have also included a discussion on other areas such as the *payments related to the teachers' strike* and *surplus asset sales*. We provide information about such areas as the Financial Statement Discussion and Analysis (which is important contextual information that often accompanies public sector financial statements), capital assets, contractual obligations and debt, and pension plans.

We would like to thank all of the government entities we worked with to complete our audit of government's Summary Financial Statements, including the Office of the Comptroller General. As well, our sincere thanks to both our staff and the private-sector auditors for their contribution. It continues to be a significant undertaking and everyone's efforts are greatly appreciated.

Carol Bellringer

Carol Bellringer, FCPA, FCA
Auditor General
Victoria, B.C.
March 2016

REPORT HIGHLIGHTS

GOVERNMENT'S SUMMARY FINANCIAL STATEMENTS

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LARGEST AUDIT IN BC

Same concern for last 3 years means **REVENUE UNDERSTATED BY $191 MILLION** this year

75% of government organizations **RECEIVED COMPLIANCE OPINIONS** due to following 2 government regulations instead of GAAP

FINANCIAL STATEMENTS TELL A STORY

STRICTER STANDARDS **INCREASED THE COST DISCLOSED** for cleaning-up contaminated sites by **$273 MILLION**

68% of annual expenses went to **HEALTH AND EDUCATION**

$135 MILLION REVENUE FROM **SELLING ASSETS**

The province has **$63 BILLION** OF DEBT

SUMMARY

This report provides details about our audit opinion on government's Summary Financial Statements for the year ended March 31, 2015. It also includes some observations about information shown in those statements, comments on the adoption of a new accounting standard for the remediation of contaminated sites, and signals the forthcoming introduction of eight new accounting standards.

AUDITOR GENERAL'S AUDIT OPINION FOR 2014/15

Audit opinions issued by independent auditors are designed to inform financial statement readers, amongst other things, the degree to which an organization's annual financial statements meet the professional standards. In most cases, audit opinions confirm that the organization met the standards.

When an organization does not meet the standards, independent auditing standards require us to tell readers which items are not in accordance. In British Columbia, this is the third consecutive year that we have concerns with government's Summary Financial Statements due to significant revenues relating to government transfers and restricted revenues not being accounted for correctly.

The issue concerns how government records revenue from other governments and outside donors that it uses to purchase or construct capital assets such as hospitals and roads. Accounting standards require that such revenues be recorded in the year they're received, unless there are strict rules from the funders that create a liability, such as requiring the revenue be repaid if not used for the purpose specified.

Government enacted a regulation that enables it to postpone recording this money until after the asset is purchased or constructed, even when there are no strict rules creating a liability, and then to recognize the revenue bit by bit on the same basis as the amortization expense of the asset. For example, if a bridge is constructed over two years, and has a life of 50 years, the standards require the revenue to be recorded in the two years that the asset is built. Instead, government records the revenue over the 50 year life of the bridge – a little bit each year. This creates a significant difference in government's annual bottom line.

ENHANCING FINANCIAL STATEMENT UNDERSTANDABILITY

Financial statements may be hard to understand for readers not schooled in accounting or business, especially those for large, complex organizations such as provincial governments. The B.C. government includes a Financial Statement Discussion and Analysis supplement at the front of its Summary Financial Statements to try and bridge this understandability gap; however, it could be improved. For example, the analysis section says that taxation revenues have increased, but it does not say *why* they have increased.

That said, there is interesting and useful information in the Summary Financial Statements. Here are some highlights.

SUMMARY

PAYMENTS TO PARENTS RELATED TO THE TEACHER'S STRIKE

Last year, government spent $11.8 billion on education. Included in this amount is the $157 million paid out to parents as a result of the teacher's strike from June to September. See page 20 for more on this.

SURPLUS ASSET SALES

In 2014/15, government recorded a gain of $135 million (2014: $601 million) from the sale of capital assets such as Burke Mountain and the Steveston Secondary School site. Its RAEG program – the release of assets for economic generation – accounted for $125 million of this amount. See page 20 for more on this.

CONTRACTUAL OBLIGATIONS

A contractual obligation occurs when government signs a contract that commits it to future payments when the terms of the contract are met. For contracts or groups of like contracts greater than $50 million, and sometimes for contracts less than $50 million that it considers significant, government discloses the future payments in a note to the financial statements. As at March 31, 2015, government and all of its organizations, including the self-supported Crowns, are contractually obligated to make at least $102 billion in future payments. See page 22 for more on this.

DEBT

Debt is the amount of money that government borrowed and must repay. Debt has repayment terms. If government should fail to meet those terms, then the debt potentially becomes payable in full, right away. Hence, it differs from contractual obligations. As at March 31, 2015, the province had debt of $63 billion. See page 25 for more on this.

NEW ACCOUNTING STANDARD FOR THE REMEDIATION OF CONTAMINATED SITES

This year, a new accounting standard regarding the costs of remediating contaminated sites (such as abandoned mines) came into effect. Previously, if government didn't have a detailed assessment of the clean-up costs for a contaminated site, it didn 't have to record a liability. Now, government is required, if at all possible, to make an informed estimate of the costs to clean up all contaminated sites that it is responsible for. As a result, government increased its liability by $273 million, recording a total liability of $397 million in the Summary Financial Statements.

Government's estimated liability for its contaminated sites was within a reasonable range. There were, however, opportunities for improvements, including estimating costs of clean up, and better documentation of those costs, which we shared with government. See page 36 for more on this.

SUMMARY

LOOKING AHEAD

In our report, we have identified eight forthcoming changes to Canadian public sector accounting standards. The first of these comes into effect beginning fiscal 2018. However, government needs to consider and address each of these changes well ahead of time to determine the impact they may have on the accounting and disclosures in both its Budget and Fiscal Plan and the Summary Financial Statements.

RESPONSE FROM THE COMPTROLLER GENERAL

I APPRECIATE THE opportunity to respond to the Office of the Auditor General's comments.

The Province of British Columbia prepares its financial statements in accordance with the *Budget Transparency and Accountability Act (BTAA)*. The BTAA requires that all financial reports be prepared in accordance with generally accepted accounting policies for senior governments in Canada, supported by regulations of Treasury Board under the BTAA. Currently, generally accepted accounting principles for senior governments in Canada are widely accepted to be *Public Sector Accounting Standards (PSAS)*.

Treasury Board may adopt all or a part of another standard such as the International *Public Sector Accounting Standards (IPSAS)* if they better represent the legislative framework that government operates under. There are currently two regulations modifying the PSAS which are outlined in this report.

In her opinion on the 2014/15 Public Accounts, the Auditor General identified one audit qualification that is outlined in this report.

Audit Qualification for 2014/15

Deferral of Government Transfers Revenue

Governments 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 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.

While addressing this issue we have to be mindful of how other jurisdictions are applying this same guidance. Failing to work with other jurisdictions would compromise the credibility of our national public sector accounting standards. To address this issue, the Office of the Auditor General has introduced their own criteria that they feel would be required to support deferral of restricted contributions. I do not agree that these criteria are consistent with accounting standards and could not agree to a material adjustment that would materially change the reported surplus under GAAP.

RESPONSE FROM THE COMPTROLLER GENERAL

Other Matters Discussed

In addition to the reservation expressed in her opinion, the Auditor General also provides observations in this report on areas of accounting or reporting that do not materially affect the financial statements.

Accounting Standards

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 257/2010 retains the pre-existing Canadian guidance on rate-regulated accounting and is required because the International Accounting Standards Board had not decided how to address rate-regulated accounting, and Canadian standard setting bodies had not provided interim direction. Standard setters have since confirmed this approach for rate-regulated accounting. The regulation is consistent with the guidance of the Canadian Securities Administrators Association and the Canadian Accounting Standards Board.
- BC Regulation 198/2011 applies to organizations within the government reporting entity and clarifies the requirement to defer contributions where appropriate stipulations are in place. The regulation 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 report provides an overview of the Financial Statement Discussion and Analysis, and makes recommendations to improve its usefulness. The observations in particular on improving the linkage between economic results and changes in tax revenue, and on referencing the Financial and Economic Review will improve the information available to the public. We will address these observations in the next Public Accounts.

Surplus Asset Sales

Ongoing management of assets is important in any large organization because there are costs associated with maintaining a stock of assets and the investment in non-productive assets means capital cannot be deployed to other more productive uses. Over the past two years the program has been effective in freeing up capital for productive uses and managing the costs of ongoing stewardship.

Contractual Obligations

The report provides information on the nature of Contractual Obligations. Contractual Obligations disclosure has attracted much attention and discussion since the introduction of this accounting standard in 2005/06. Not all of it has been positive because using the word “obligations” in the title has a connotation sometimes equated with debt.

RESPONSE FROM THE COMPTROLLER GENERAL

All organizations conduct a part of their operations through contracted services, usually because it is economical to do so, or because the services required are specialized. Even the Office of the Auditor General reports "commitments" for leased premises and office equipment. The size and the nature of the organization determine the scope of contracted services.

We disclose contractual obligations by sector in the Summary Financial Statements because that approach is consistent with accounting guidance on segment disclosures, and because the sectors used will be consistent over a long period of time, which should allow greater long term comparability for users of the financial statements. We also disclose information on the types of contracts separately with our supplemental reports to the Public Accounts where we include all the background information that supports the financial statements.

Information About Pension Plans

British Columbia's public sector Pension Plans are recognized as being among the best retirement systems in the world because they are a collaboration between employees and public sector employers to provide affordable and sustainable retirement income to contributors while avoiding the risks faced by other types of plans in periods of economic stress. This has been achieved through a commitment to evolve as workforce demographics and economic environments change.

The challenge in accounting for complex retirement systems is to faithfully represent the position of employers, plan members, and the sponsoring boards of trustees. Accounting standards setters are undertaking work in this area and in this report the Auditor General has observed opportunities for improvement that we will adopt in the next Public Accounts.

Remediation of Contaminated Sites

Working collaboratively with the Office of the Auditor General on the implementation of changes to the accounting standard for the Remediation of Contaminated Sites was very beneficial. The result is the most successful implementation of this standard with the fewest outstanding issues to resolve. As noted in this report there are opportunities to improve the information used to estimate future costs as experience occurs in the years after implementation.

I believe that we have continued to improve the high quality of financial accountability reporting through these financial statements. We will continue to work with the Auditor General and the broader accounting community to resolve the one remaining qualification included in the Auditors report.

Stuart Newton
Comptroller General
Province of British Columbia

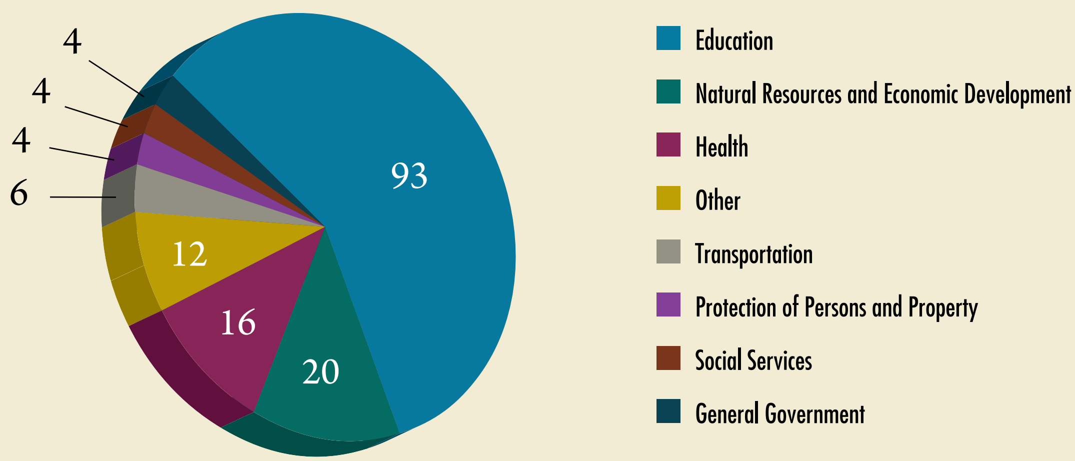
BACKGROUND

AT THE END of every fiscal year, the Government of British Columbia combines the financial information of all the entities within its control and produces a consolidated set of financial statements called the Summary Financial Statements. The Summary Financial Statements are important to the people of B.C., as among other things, they provide an indication of the financial well-being of the province.

The 2014/15 Summary Financial Statements reports on the annual consolidated financial results of the 159 ministries and entities that make up the government reporting entity. This includes core government (ministries), Crown corporations, colleges, school districts, universities, health authorities and other public-sector entities (see Exhibit 1).

The Crown corporations, colleges, school districts, universities, health authorities and other public-sector entities are an important part of how government delivers its programs. In terms of dollars spent, 60% of government programs are delivered by these organizations, and 40% are delivered by central government (ministries).

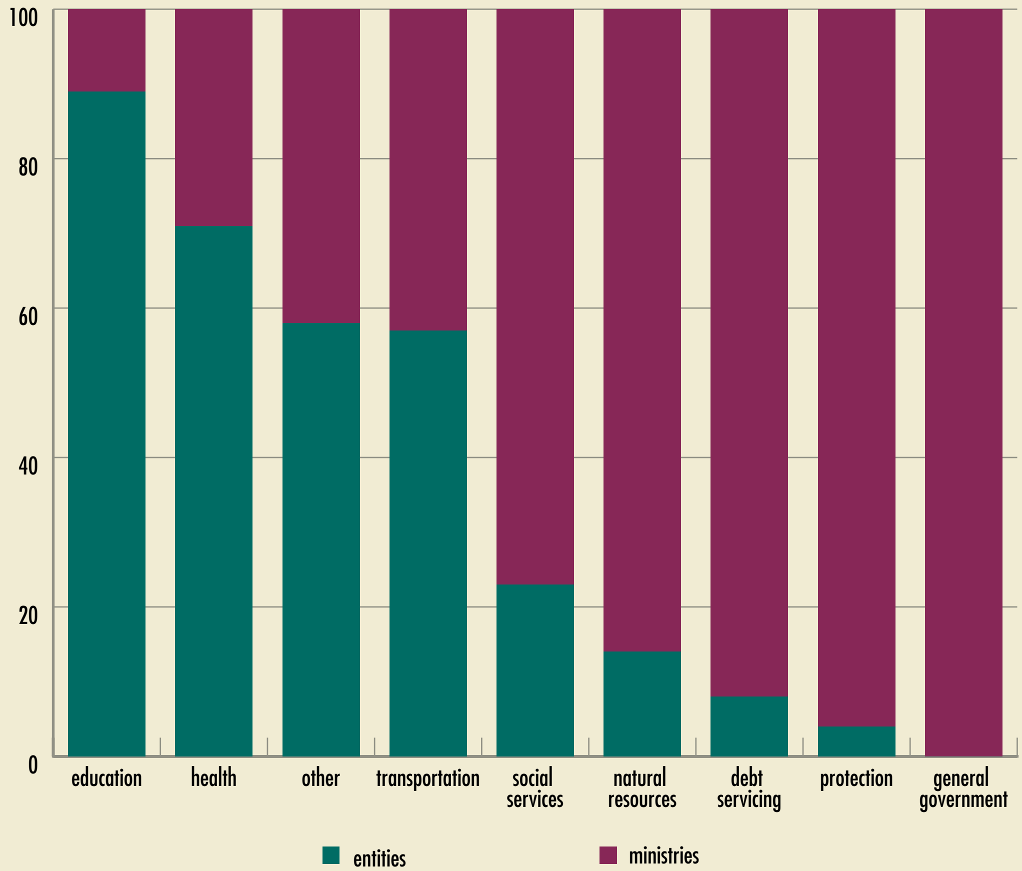
Exhibit 1: Number of government entities including ministries in the 2014/15 Summary Financial Statements, grouped by sector



Source: compiled by the Office of the Auditor General of British Columbia from the Province of British Columbia Public Accounts 2014/15, pages 83 to 85

BACKGROUND

Exhibit 2: Dollars spent by sector by ministries compared to entities (as percent)



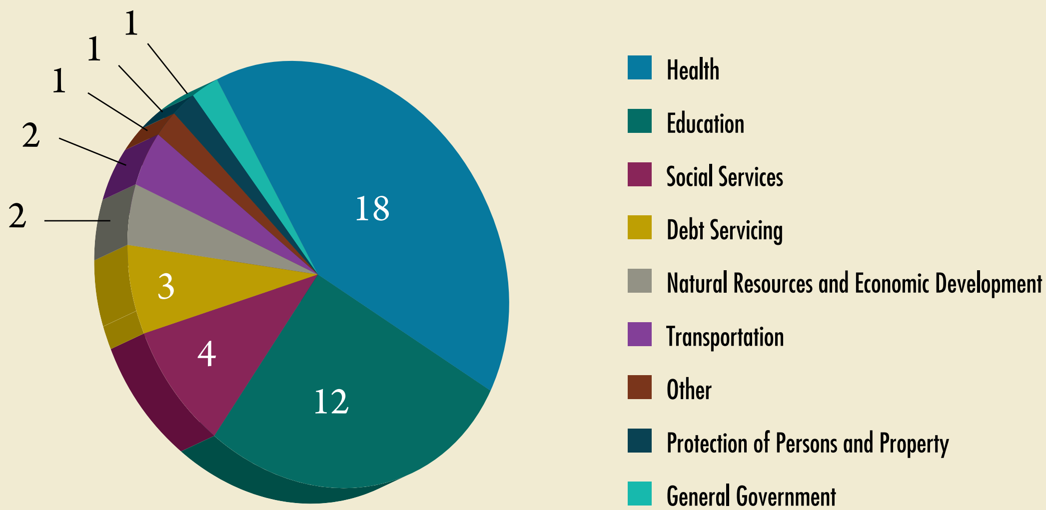
Source: compiled by the Office of the Auditor General of British Columbia from consolidated public accounts data

The overall 60 / 40 entity / ministry ratio varies by sector. Most of the "health" and "education" spending is in the entities; spending in the "transportation" and "other" sector is roughly 50%; and most of the spending on "social services," "natural resources and economic development," "protection of persons and property," "general government" and "debt servicing," is in the ministries. See Exhibit 2 for more information.

The spending on these programs, and the revenues that make that possible, are all included in the Summary Financial Statements, which reports $46 billion in revenue, $44 billion in expenses (see Exhibit 3), $85 billion in assets and $81 billion in liabilities. As the self-supported Crown corporations and agencies[1] are accounted for using the modified equity method, in accordance with Canadian Public Sector Accounting Standards (PSAS)

[1] Self-supported Crown corporations and agencies are corporations such as BC Hydro and ICBC, that get sufficient revenue from sales outside government to cover their expenses and debt payments. These corporations are listed on page 85 of the Public Accounts.

Exhibit 3: Government expenditures in 2014/15, grouped by sector ($ billions)[2]



Source: compiled by the Office of the Auditor General of British Columbia from the Province of British Columbia Public Accounts 2014/15, page 42

requirements, these financial statements do not fully consolidate them. If PSAS required these entities to be consolidated on a line-by-line basis, revenues and expenses would increase by $14 billion, and total assets and liabilities by $21 billion.

OUR ANNUAL FINANCIAL STATEMENT AUDIT OF THE SUMMARY FINANCIAL STATEMENTS

Under section 11(1) of the *Auditor General Act*, our Office is required to report on whether the province's Summary Financial Statements are presented fairly in accordance with Canadian generally accepted accounting principles (GAAP). This is the largest audit in B.C., and takes 65 staff and contractors in our Office just over 42,000 hours to complete. It also requires assistance above and beyond our work from 25 private-sector auditing firms.

[2] This is not a complete listing of the province's expenditures for the 2014/15 fiscal year; expenses of self-supported Crown corporations are excluded from this chart.

BACKGROUND

Government's Public Accounts include:

- the Auditor General's report (or opinion)
- the Summary Financial Statements
- our Office's separate audit opinion on the Total Provincial Debt and related Debt Indicators
- the Provincial Debt Summary
- unaudited information, such as government's Financial Statement Discussion and Analysis report
- information about the Consolidated Revenue Fund and other aspects of the provincial debt

For the 2014/15 Summary Financial Statements, we issued a modified report this year because government did not comply with GAAP when they deferred certain types of revenues. In our view, the government should have recorded $191 million more revenue in the current year, and just over $4 billion more in prior years. See Our Audit Opinion on the Summary Financial Statements section in this report.

This report discusses some items of interest in the government's Summary Financial Statements, our modification to the audit opinion, and other matters relating to the Public Accounts.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

THE SUMMARY FINANCIAL STATEMENTS tell readers much more than just the province's bottom line. They are packed with important and useful information – particularly in the notes – and tell an interesting story about the financial health of our province.

For example (and in no particular order):

- How much did government spend on health?
- What is the total debt, and how much interest is government paying?
- Where does the cash come from, and what is it used for?
- What degree of estimation is involved in arriving at the figures?
- How much of the debt is in foreign currencies?
- Have there been any changes to the accounting policies, and what impact did they have?
- What is the possible liability for lawsuits or environmental clean-up?

To help readers understand and learn from these types of statements, our Office produced a guide *Understanding Canadian Public Sector Financial Statements* in June 2014. The guide describes what can be found in the statements and notes, and includes suggested questions that readers should ask about public sector financial statements.

Government has the opportunity to discuss the financial results of the province for the fiscal year and what they mean in the Financial Statement Discussion and Analysis (FSD&A) section. In this section of this report, we highlight some ways that the FSD&A could be improved, and an example of some key analysis that was not included in the FSD&A that we believe is important for interpreting and understanding the bigger picture of the 2014/2015 Summary Financial Statements.

THE FINANCIAL STATEMENT DISCUSSION AND ANALYSIS SHOULD ENHANCE UNDERSTANDING

Although not part of the audited financial statements, a sound FSD&A is important contextual information that often accompanies public sector financial statements.

The main objective of an FSD&A is to clearly explain and highlight information underlying the statements of financial position, and changes in financial position,

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

as presented. FSD&A information often includes narrative explanations and graphical illustrations highlighting the key relationships in the quantitative representations, as well as explanations and illustrations of variances and trends.

FSD&A information needs to:

- enhance the reader's understanding of government's financial position and results of operations, so they can make more informed decisions and judgments
- enable the government to demonstrate its accountability for the resources entrusted to it

The FSD&A should include:

- a highlights section that provides a brief, concise summary of the significant events affecting the financial statements
- an analysis section that
  - discusses the risks and uncertainties affecting government's financial position and how those are being managed
  - identifies and explains differences between actual results to budget and prior year
  - explains the significant trends in the financial statements, such as increases or decreases in debt, revenues and expenses

This is all included in the Public Sector Accounting Board's (PSAB) Statement of Recommended Practice number 1 "Financial Statement Discussion and Analysis."

In the Public Accounts 2014/15 report, the FSD&A starts on page 11.

We have been encouraging government to improve its FSD&A since fiscal 2006/2007, along the lines recommended by PSAB's Statement of Recommended Practice. In our view, there is still room for improvement.

The highlights section, for example, should provide a brief, concise summary of the significant events affecting the financial statements. It should not simply reiterate the information that is presented in the financial statements, but add value by providing an executive overview of those statements and the significant in-year activities that have affected them.

Government's highlights section provides a high-level comparison of budget to actual, and to the prior year, without any discussion as to the significant events affecting the financial statements for the fiscal year. For example:

- in a number of places, the FSD&A points out a significant increase in taxation revenue of $2.1 billion compared to last year
- on page 18, it shows how that increased the surplus compared to the prior year
- on page 19, it shows how the increase of $899 million in taxation revenue compared to budget is a major reason the surplus is more than budget

But nowhere does it say *why* taxation revenue increased.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

We reviewed the FSD&A for all Canadian provinces and territories, and found that nine of them had better explanations for differences between actual results to budget and prior year than B.C. In many ways, the B.C. FSD&A identifies questions without answering them.

When we discussed this with the government, they pointed out that the Financial and Economic Review published in July 2015 addressed many of these issues. We found that part 2 of this document addresses the results for the fiscal year, and the questions we pose above have, indeed, been answered. In particular, the reasons for the increase in taxation revenue are explained. Unfortunately, as far as we can tell, the Review was published on the government website with no public announcement, so its usefulness as an adjunct to the Public Accounts is diminished.

In our view, the explanations in the Financial and Economic Review should be included in the FSD&A that is in the Public Accounts, as recommended by the PSAB Statement of Recommended Practice. If government does not wish to do this, it should at least ensure the two documents reference each other. At a minimum, the publication of the Financial and Economic Review should be announced so those interested in learning the backstory to the Public Accounts know it's available.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

PAYMENTS TO PARENTS RELATED TO THE TEACHERS' STRIKE

On page 42 of the Consolidated Statement of Operations, government discloses total education expenses of $11.8 billion. Included in this amount is the $157 million paid out to eligible families that registered for the Temporary Education Support Payment (TESP) program.

The teachers' strikes in June 2014 and September 2014 resulted in a savings to the government of about $186 million. Most of the savings were due to reductions in the costs of school districts, by not having to pay teachers' wages.

Government used most of the savings to fund the TESP program. This program was to help parents cover the costs for eligible caregivers of students who were 12 and under, and to help with the costs of educational learning and supervision due to the strike.

SURPLUS ASSET SALES

In 2014/15, government recorded a gain of $135 million from the sale of capital assets. Its RAEG program – the release of assets for economic generation – accounted for $125 million of this amount.

When the RAEG program was first announced in 2012, government stated this initiative would see a number of surplus properties and assets for sale over the next number of years. They defined surplus properties as: those no longer in use, not required for future utilization, or where there was no strategic benefit for government to be the owner. The sale of these surplus properties was intended to provide much needed revenue to the Province and also to generate economic activity around British Columbia.

Property and asset sales have provided revenue to the Province. In 2013/14, government earned $601 million from the sale of assets, and in 2014/15 it earned $135 million.

Government originally budgeted for gains of $200 million in 2014/15, but in the third quarter update for 2014/2015, government announced it would defer some asset sales until 2015/2016, to ensure that taxpayers get maximum value, and projected that revised gains for 2014/2015 would be $121 million. Actual gains from the RAEG program for 2014/2015 were $125 million, and a further $10 million in gains came from asset sales outside the RAEG program.

The total gains of $135 million, and the proceeds from the sales, can be found in the statement of cash flows on page 44.

Some of these sales have been high profile, with questions being asked about the value obtained. As a result, and as announced in our Performance Audit Coverage Plan released in July 2015, our Office will look into whether government followed appropriate processes to achieve value for money from the sale of these assets.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

CAPITAL ASSETS – A KEY PART OF HOW GOVERNMENT DELIVERS SERVICES FOR CITIZENS

In government financial statements, capital assets are generally used for providing services such as hospitals for health care, schools for education, and highways as part of the province's transportation network.

Capital assets last for a number of years, and so they are presented as assets in the financial statements, not as expenses.

For example, when government buys office supplies, the cost is shown as an expense in the statement of operations when the supplies are purchased.

However, when government buys or constructs a capital asset, the cost is shown as an asset, not an expense. What does show as an expense is the annual allocation of the cost of the asset, called amortization. This is all in accordance with PSAS.

For example, if a building cost $10 million to construct over two years, and government estimated the building to have a useful life of 50 years, government would record an amortization expense of $200 thousand ($10 million divided by 50) each year, starting after it has been built. There would be no expense in the years that it was being built.

Sometimes government leases these assets. When it does, if the risks and rewards of ownership are substantially transferred to the government, PSAS requires the assets to be accounted for the same way as those purchased or built as described above.

As capital assets are a fundamental foundation in providing services to the public, our Office will be looking into how government assesses, manages and reports future costs to maintain capital assets. We announced this in our Performance Audit Coverage Plan released in July 2015.

Details of government tangible capital assets are in Note 22 on page 71 and in a supplementary statement on page 98 of the Summary Financial Statements.

DIVIDENDS RECEIVED FROM SELF-SUPPORTED CROWNS ARE NOT REVENUE

To most of us, dividends are revenue. We invest in shares, and receive dividend income. The government also invests in shares, generally as part of pooled investment portfolios, and records the dividends received as revenue.

However, when the shares government owns are the shares of corporations controlled by the government, different accounting rules apply. In these cases, government consolidates the corporations, thereby including the corporation's net income (or loss) in the government's financial statements.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

This is most visible with shares of the self-supported Crown corporations, since PSAS requires the use of modified equity accounting for these Crowns. This means that government shows the net income of these Crowns as revenue in its statement of operations, and increases its investment by the same amount. The actual dividend then becomes a transfer of cash from the Crown to the government. At the end of the day however, these Crowns are part of the government reporting entity, as are all of their assets, liabilities, revenues and expenses. The difference in presentation is due to accounting standards.

The net earnings in 2015 of government's self-supported Crown corporations and agencies was $3.3 billion, and the dividends paid out of those earnings were $2.6 billion. These net earnings and dividends can be found in the statement of cash flow on page 44 and on the supplementary schedule on page 97.

CONTRACTUAL OBLIGATIONS

When government signs a contract that commits it to future payments, it discloses those future payments as a contractual obligation in a note to the financial statements. See Note 27(c).

The disclosures in the note are for payments for contracts greater than $50 million that the government and all of its organizations, including the self-supported Crowns, are contractually obligated to make. When looking at the $50 million limit, government also includes smaller but similar contracts which, when grouped together, are more than $50 million. It also from time to time includes other contracts which it considers significant, even though they are less than $50 million. PSAS does not specify a dollar limit for the disclosure of contractual obligations. These disclosures, correctly, do not include contracts that simply set rates at which contractors may be paid if services are provided.

For example, a lease would be included in contractual obligations because government must make payments for five years; but, a contract for legal services that specifies the hourly rate, but where there is no minimum payment, would not. If no legal services are required, no payments need to be made, but in the case of a property lease for office space, payments need to be made whether or not government occupies the premises. So the contracts with the doctors, for example, are not included, since they set rates for services.

Contracts with employees are not included, nor are transfers where eligibility conditions must be met for each payment, such as income assistance payments. A distinction is made between contracted obligations and a government's obligations related to ongoing programs such as health, welfare and education. In these cases, a government does not have a contractual obligation to others and maintains complete discretion as to whether to change the level or quality of its programs or the delivery of these programs.

Contractual obligations are disclosed because they give information about government's future committed expenditures. This reduces government's

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

flexibility, but also locks in the prices for future services. The amount disclosed is based on signed contracts in existence at the fiscal year-end, and this can cause variations in the disclosure over the years:

- At the end of 2009/2010, government's total contractual obligations were $53 billion.
- At the end of 2010/2011, BC Hydro had signed agreements with independent power producers of $25 billion, which was the main reason for the increase in the total to $80 billion.
- At the end of 2011/2012, BC Hydro had signed more agreements with the independent power producers, and government had entered into a new contract with the RCMP for provincial policing arrangements. These new contracts added $16 billion, and the total at year-end was $96 billion.
- By March 31, 2015, the total had risen to $102 billion.

This total is not all payable at one time. It is spread out over many years. The contracts BC Hydro has signed extend for up to 56 years into the future. Of the $102 billion, almost $9 billion is expected to be paid in 2016, $6 billion in 2017, $5 billion in 2018, and lesser amounts each year going forward.

Government's disclosure is in Note 27(c) of the Summary Financial Statements, and more detail concerning what the contracts are for can be found on their website.

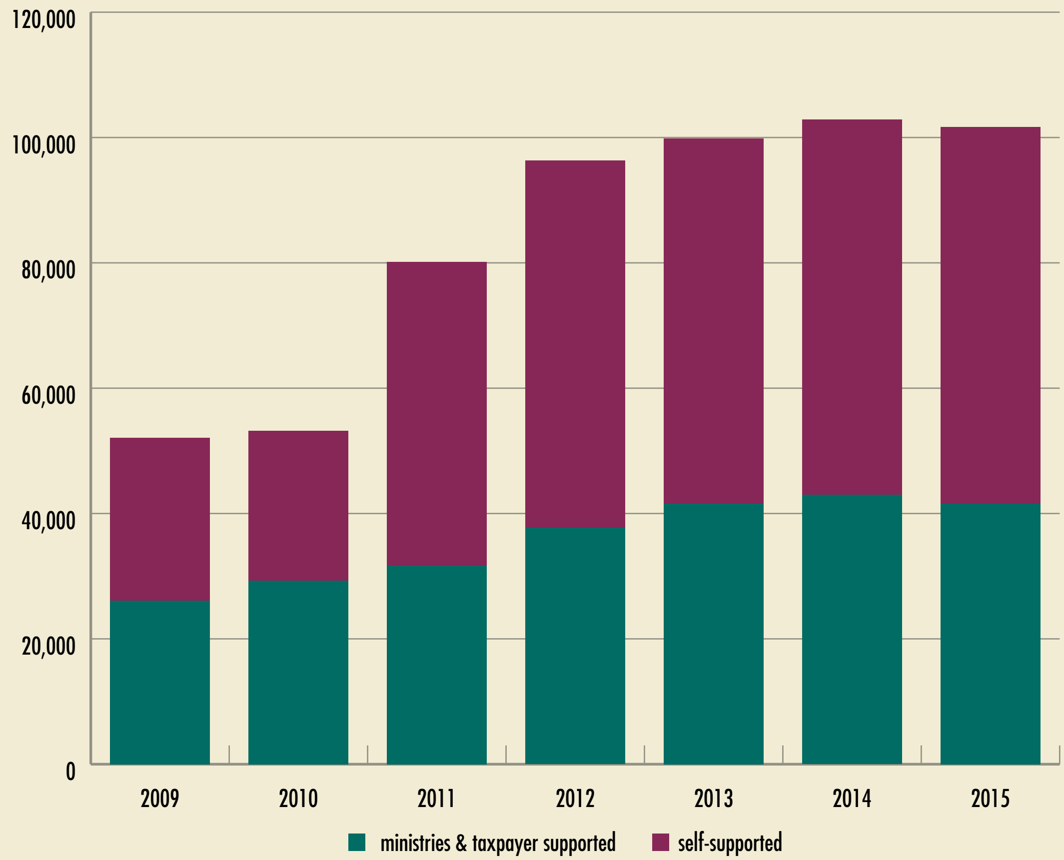
We have made recommendations in prior years that additional information, such as what is on the website, be included in the Summary Financial Statements:

- Report in 2006/07, recommendation no.4 (p. 16), Report in 2007/08, recommendation no.10 (p. 47), Report in 2008/09, recommendation no.5 (p. 44) and Report in 2009/10, recommendation no.6 (p. 26) We recommend that government include additional information about the nature of the contractual obligations in the Summary Financial Statements.

Exhibit 4 shows the total amount of future payments that government is committed to make when the terms of the contract are met. These contractual obligations can last anywhere from 1 to 50+ years. It shows separately the contractual obligations of the self-supported Crown corporations and agencies, and the ministries and taxpayer supported entities.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

Exhibit 4: Future total payments for contracts signed on or before March 31



Source: compiled by the Office of the Auditor General of British Columbia from the Province of British Columbia Public Accounts 2014/15

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

CONTRACTUAL OBLIGATIONS AND DEBT

The question is often asked, what is government's total debt? (Answer: $63 billion at March 31, 2015.) Should that include the $102 billion of contractual obligations? (Answer: no.)

Contractual obligations are different from debt. Debt is the amount of money that government has borrowed, and which must be repaid. Debt has repayment terms. If government should fail to meet those terms, then the debt potentially becomes payable in full right away.

This is the difference with contractual obligations, in that they must be paid, but not right away, only at fixed dates in the future as the service or goods are provided.

Exhibit 5: Summary Financial Statements debt total

Debt ($millions)	2015	2014
Mortgages	194	203
Capital leases	196	176
P3's	2,586	2,318
Other	39,717	39,064
Total Tax-payer –supported	42,693	41,761
Self-supported	20,465	19,041
TOTAL debt	63,158	60,802

Source: compiled by the Office of the Auditor General of British Columbia from the Province of British Columbia Public Accounts 2014/15.
See note 18 and 19.

In addition there is $720 million of self-financing debt of the self-supported Crown corporations and agencies that is not required to be disclosed in the Summary Financial Statements per PSAS. The Columbia Basin power projects debt of $464 million and the UBC Property Trust debt of $206 million make up the majority of this $720 million.

Finally, there is the debt that government has guaranteed, disclosed on page 99. At the end of 2014/2015, this amount was $19 million. Ten million of it is for BC Hydro bonds, and $9 million is for guarantees under programs where government guarantees the debt of persons or organizations outside government. Government expects that, at most, it will have to make payments on $7 million of the loan program guarantees.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

INFORMATION ABOUT PENSION PLANS

The government has four jointly trusteed pension plans that cover the majority of government employees. They are the Teachers' Pension Plan, the College Pension Plan, the Public Service Pension Plan, and the Municipal Pension Plan. There are over half a million active, retired and inactive[3] members in these plans.

JOINT TRUSTEE PLAN

The four main government pension plans are joint trustee plans, meaning that the Pension Boards are fully responsible for the management of the plans, including both administration of the plans and investment of the assets. Half of the board members are appointed by plan employers and half are appointed by the unions and professional associations representing plan members. As explained in note 17 to the Summary Financial Statements, the provisions of the plan stipulate that the province has no formal claim to any pension plan asset. In addition, as a joint trustee, the province's conditional share in any liability is limited to 50%.

The table in Note 17(d) of the Summary Financial Statements shows the accrued benefit obligation for each plan, the fund assets, the unamortized actuarial gain or loss, and the net asset or obligation for each plan. In other words, it shows the actuarially calculated liability for the amount of pensions payable for the current plan members, the assets that the pension plan has available to meet that liability, the amount of the current expected gain or loss that has not yet been taken into account, and the resulting estimated net asset or liability.

The table also shows there is an overall net asset of $1.5 billion, and that within that overall net asset, there is net liability for the Teachers' Pension Plan of $519 million.

How does this relate to the liability of $259 million recorded in the Summary Financial Statements for the Teachers' Pension Plan?

A reader can discover the answer in the text of Note 17 on page 62. The note says that the plans are under joint trust arrangements (see sidebar) which limits government's possible conditional share to 50%. In addition, the government has no claim on the accrued asset amounts – only if the pension boards decide to reduce or suspend the employer contributions for a period of time would the government be able to record an asset.

However, in the case of a liability, the government is responsible for 50%. As shown in the table in Note 17(d), the Teachers' Pension Plan has a net liability of $519 million, so the government is recording a liability of 50%, or $259 million.

[3] Inactive members are original members who have terminated their employment with a plan employer but have left their contributions (or accrued benefit) in the plan.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

We have asked the government to clarify this, and have suggested adding two additional lines of disclosure to the table to make this clear: government's conditional share, as a percentage, and the net amount recorded. This would allow the number in the note to be directly agreed to the table without readers needing to work through the text in order to do the math. We have also suggested that comparative amounts be shown, as required by PSAS. The table would then look like Exhibit 6.

We have also been asking government to provide additional information, as required by PSAS, to help readers understand pension cash flow requirements, and the amount of employer vs. employee contributions to the plan.

However, government has told us that this information is not being provided to them by the Pension Plan Boards.

Exhibit 6: Suggested pension plan disclosure ($ millions)

	Public Service Pension Plan	Municipal Pension Plan	Teachers' Pension Plan	College Pension Plan	Total 2015	Total 2014
	$	$	$	$	$	$
Accrued benefit obligation	16,635	21,697	18,049	3,082	59,463	57,098
Pension fund assets	17,510	20,738	16,499	3,042	57,789	54,613
	(875)	959	1,550	40	1,674	2,485
Unamortized actuarial gain (loss)	(349)	(1,662)	(1,031)	(138)	(3,180)	(4,427)
Accrued net obligation (asset)	(1,224)	(703)	519	(98)	(1,506)	(1,942)
Government's conditional share %	50%	50%	50%	50%		
Net obligation recorded (note)	nil	nil	259	nil	259	
Net obligation recorded (note) 2014	nil	nil	212	nil		212

Note: as stated in the text, government has no claim on the net assets.

Source: Compiled by the Office of the Auditor General of British Columbia from note 17(d) of the 2015 Summary Financial Statements with additional disclosure – shaded in grey – added by the OAG

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

WHAT DO THE CREDIT RATING AGENCIES LOOK FOR?

Credit rating agencies use the information contained within the Summary Financial Statements when determining a credit rating, although they do not rely solely on them. Each agency has its own methodology for determining a credit rating, which includes conducting further work and often involves a visit to the Ministry of Finance and access to additional data.

The agencies' role is to provide lenders with an estimate of how much risk there is that they may not be repaid. A key part of that risk is the cash flow. Will the borrower have cash available at the time the payments are due? As a result, the agencies look beyond the operating result for the year and factor in cash flow related to other things such as construction of long-term infrastructure projects.

So although the Summary Financial Statements provide a reliable starting point, the rating agencies make a number of adjustments to the numbers before arriving at their own calculation.

The ratings matter to the government because they play an important role in determining the rate of interest lenders will charge. The higher the risk that the debt will not be repaid, the higher the rate the investor will charge. A higher interest rate means higher interest payments and fewer funds available for provincial programs. In 2015, interest expense was $2.5 billion, just over 5% of the total expenses for the year.

CREDIT RATING

A credit rating is an evaluation of a borrower's ability to pay back their debt, with interest, and the likelihood of default.

It is the result of quantitative and qualitative analysis of some key credit factors, including:

- Economic conditions: government's ability to generate revenue by taxation and other fees, through a strong and diversified economy and the projection of government's needs that would impact its future expenditures (e.g., costs to cover an aging population or future infrastructure needs).
- Governance and fiscal management: government's budgetary and oversight practices to meet its fiscal goals. It also looks at the transparency and timeliness of financial information.
- Institutional framework: the fiscal policy framework to maintain governmental expenses and government's ability to adapt policies to changing circumstances.
- Financial and debt management: the historical and forecast financial data to determine government's ability to generate revenue to cover its loan repayments and interest.

A credit rating helps lenders to assess the risk of lending money, and compare the risk and return of different investments.

THE SUMMARY FINANCIAL STATEMENTS TELL AN INTERESTING STORY

Below are the three credit agencies that government uses, and their credit assessments of British Columbia:

Credit Rating Agency	Long Term (greater than one year)	Short Term	Outlook	Issued
Standard and Poor's	AAA	A-1+	Stable	May 25, 2015
Moody's Investors Services	Aaa	P-1	Stable	April 8, 2015
Dominion Bond Rating Service	AA (high)	R-1 (high)	Stable	April 20, 2015

The long-term and short-term ratings that government received from Standard and Poor's and Moody's Investors Services, and the short-term rating from Dominion Bond Rating Service, are the highest credit ratings possible. The long-term rating from Dominion Bond Rating Service is the second highest.

Government discloses the long term ratings in its FSD&A, where it also shows the credit ratings received by other provinces and Canada. Their chart shows that British Columbia is ranked highest across the country by Moody's and Standard and Poor's, and third highest by Dominion Bond Rating.

OUR AUDIT OPINION ON THE SUMMARY FINANCIAL STATEMENTS

CANADIAN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ARE KEY TO CREDIBLE FINANCIAL REPORTING

For the fiscal year starting April 1, 2004, B.C. became a leader among governments in Canada, when legislation enacted in 2001 came into force (section 23.1 of the *Budget Transparency and Accountability Act*) requiring the province's Summary Financial Statements to be prepared in accordance with generally accepted accounting principles (GAAP) which is PSAS in Canada. That was changed in 2010 so that for the fiscal year commencing April 1, 2010 and subsequent years, the province's Summary Financial Statements are now prepared in accordance with GAAP for senior governments in Canada, which is still PSAS, but as modified by government regulation.

Accountants use GAAP in the preparation of financial statements. Auditors use them as a yardstick to assess whether the standards have been met to form an independent opinion on the fairness of the statements. By adopting these standards and putting them into law, the Government of B.C. demonstrated its commitment to carrying out high-quality financial reporting and producing credible, consistent financial statements that are comparable with those of other jurisdictions.

All levels of government across Canada use a form of GAAP specifically designed for the public sector, called Public Sector Accounting Standards (PSAS). These standards are issued by the Public Sector Accounting Board – an independent standard-setting body.

Independence in developing accounting standards is extremely important. 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. How each jurisdiction applies GAAP does vary sometimes, due to differences in legislation, regulations, composition of the government reporting entity, and interpretation of the accounting standards.

OUR AUDIT OPINION ON THE SUMMARY FINANCIAL STATEMENTS

GOVERNMENT'S AMENDMENTS TO GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Section 23.1 of the *Budget Transparency and Accountability Act* requires the provincial government and its entities to conform to PSAS. However, as we have said in prior year versions of this report, government has also given itself the ability to make regulations that change PSAS as it chooses. While we note that any regulation made by government must adopt all or part of a standard that comes from other Canadian GAAP, or from another jurisdiction's GAAP, this still puts the government at risk of being non-compliant with PSAS and reducing comparability with other jurisdictions.

To date, government has passed two regulations under the Act that allow it to modify Canadian PSAS.

Not adhering to GAAP significantly reduces the comparability and, potentially, the consistency of financial reporting. Instead of using an independently agreed-upon standard measure to assess financial performance for governments in Canada, government set its own rules for how its financial performance should be measured and reported to the people of B.C.

Our Office remains concerned that government has created accounting policies that are inconsistent with independently developed accounting standards for governments in Canada. As we have reported previously, this may obscure the true financial performance and position of government. We again encourage government to report to the public as required by accounting standards developed by independent Canadian public sector standard-setters, and to stop using its own regulations that deviate from these standards.

The first such regulation government passed relates to BC Hydro deferring expenses or revenues into the future:

B.C. Regulation 257/2010 – Government directed BC Hydro to adopt part of a U.S. accounting standard (FAS980 Regulated Operations) in 2012 to account for the effects of rate regulation.

Rate-regulated accounting allows utility companies to recognize the decisions of the regulator that have the effect of deferring (or smoothing) their expenditures and revenues over multiple years when they would otherwise be accounted for as an expense or revenue in the current year. For more information on this, see our follow-up report, *BC Hydro: The Effects of Rate-Regulated Accounting*, issued in June 2014.

Although B.C. Regulation 257/2010 was issued at a time when it appeared rate-regulated accounting would soon not be allowed in Canada, the requirement for utility companies that use rate-regulated accounting to fully adopt International Financial Reporting Standards (IFRS) has been deferred indefinitely. Therefore, there has been no impact to the Summary Financial Statements as a result of this regulation.

OUR AUDIT OPINION ON THE SUMMARY FINANCIAL STATEMENTS

The second regulation government passed relates to entities deferring revenues into the future:

B.C. Regulation 198/2011 – In 2012/13, new PSAS accounting standards for government transfers and restricted revenues came into effect. These standards set stricter rules on what kinds of revenue can be deferred and accounted for at a later date. The result of the new standard would most likely be government recording revenue from other governments sooner. This regulation directs government entities to continue deferring government transfers and restricted revenues. Government has consistently expressed its view that this is an acceptable interpretation of the new accounting standards. However, our Office and other independent auditors of government entities in B.C. do not consider the regulation to be an acceptable interpretation of the standards; instead, it actually changes them.

When government entities defer these types of government transfers and restricted revenues in accordance with the regulation, they are not complying with PSAS. As a result, many of those entities received either a non-GAAP compliance or a modified GAAP audit opinion this year. See types of audit reports.

The regulation applies to government entities and not to the government's Summary Financial Statements. However, since those entities have been consolidated without any adjustments for the impact of the regulation, this materially impacts the Summary Financial Statements. See our 2014/15 Audit Opinion.

TYPES OF AUDIT REPORTS

In Canada, audit reports represent an auditor's independent, professional opinion on whether an organization's financial statements are presented fairly in accordance with Canadian generally accepted accounting principles. Audit reports can also identify any concerns auditors have with the quality of the financial statements.

The auditors of the 2014/15 audit of government entities included in the Summary Financial Statements issued three different types of audit reports:

1. unmodified
2. modified (concerns expressed as qualifications)
3. compliance

1. Unmodified report

An unmodified report, also referred to as a clean opinion, means that the auditors are satisfied that the financial statements are fairly presented, including the entity's financial position and results of operations.

2. Modified report

On the rare occasion that auditors issue a *modified report*, it means they have concerns with:

- the availability of sufficient and appropriate information for users to make an informed decision, or

- uncorrected errors caused by the entity's application of accounting standards (GAAP)

A modified report may contain:

- a qualification, when there is an error or omission in the financial statements that the auditor can quantify and explain so a user can consider the effect on the financial statements,
- an adverse opinion, when an error or omission is so material or pervasive that even though it can be quantified and explained, the auditor considers that the financial statements as a whole are misleading, or
- a disclaimer of opinion, where the auditor is unable to get sufficient appropriate audit evidence to form an opinion,

In determining whether a modification is necessary, the auditor considers the significance of the errors or missing information in relation to the financial statements as a whole. In addition, the auditor considers the errors individually and in total. The auditor sets a numerical threshold for materiality, and if the errors are less than that, no modification is needed.

But if the errors exceed that threshold, then the auditor might modify the audit opinion for those errors. Before doing that, however, the auditor presents these errors to management of the organization to allow them an opportunity to correct the errors.

However it is more than just the numerical amount of the error. The auditor must also consider qualitative factors. For example, if a small error would change an overall deficit into a surplus (or vice versa); or, if a disclosure in the notes is not complete or provides inappropriate information, then this may be considered to have a material effect and therefore be the subject of a modification.

3. Compliance report

Auditors can also issue a compliance audit report if an entity's financial statements are presented according to its chosen or legislated framework, but not in accordance with GAAP. The entity must include a note with its financial statements explaining how they would be different if it were adhering to GAAP, and the auditor's report must reference this note.

AUDITOR'S REPORTS FOR GOVERNMENT ENTITIES

This past fiscal year, 104 of the 141 entities receiving separate audit opinions had compliance audit reports because they were required to follow the regulation government issued related to the deferral of certain government transfers and restricted revenues, and as a result of doing so their auditors considered that their financial statements were inconsistent with GAAP.

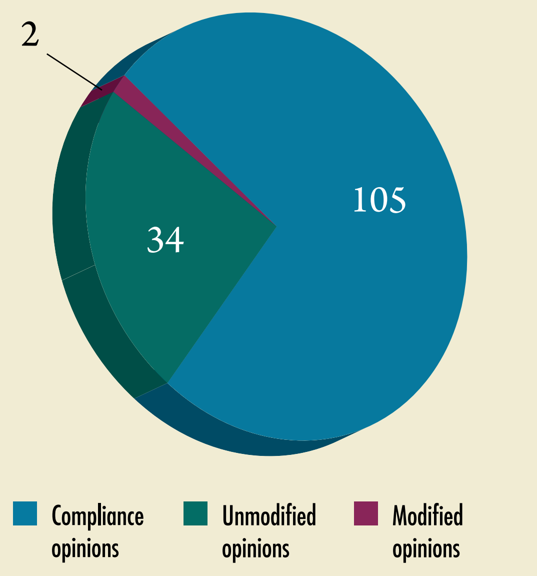
Of the 104 compliance opinions, our Office issued 10 of them for entities that we audited. We are currently re-considering whether we should continue to issue compliance opinions in the future. We are concerned that compliance opinions are not appropriate for general purpose financial statements that are designed to meet the common financial information needs of a wide range of users.

OUR AUDIT OPINION ON THE SUMMARY FINANCIAL STATEMENTS

Thirty-four entities received an unmodified audit report (the entity's financial statements were fairly presented), and two entities received modified audit reports – one of those (BC Transportation Financing Authority) was because of how it treats government transfers and restricted revenues; the other, a hospital society, related to the basis of preparation of an actuary's report that was used to determine a liability. BC Hydro also received a compliance audit report, because it is following the regulation described above.

Auditors should rarely have concerns with financial statements, yet there continue to be a notable number of entities in the B.C. government reporting entity that received compliance or modified audit reports this year (see Exhibit 7).

Exhibit 7: 2014/15 compliance and other types of auditors' reports for government entities



Source: Compiled by the Office of the Auditor General of British Columbia

AUDIT OPINION FOR 2014/15

For fiscal 2014/2015, government included $4.2 billion in its deferred revenue, mainly relating to the purchase or construction of assets, which it will recognize in the statement of operations as revenue in future years.

This deferred revenue comes from two sources: transfers from other governments and revenues from non-government sources, where the contributor has specified that the revenue must be used to purchase or construct assets.

While there are two different sections in PSAS for accounting for these two types of revenue, the effect is basically the same: the funds should be recognized as revenue in the statement of operations as they are used for asset purchase or construction. Instead, Government is recognizing these funds over the life of the assets it has built or purchased. However, in our view, under PSAS, government is not allowed to do that for $4.2 billion of these funds.

For example, where government is recognizing the revenue it received to construct a building over its 50-year life, according to Canadian PSAS, the revenue should be recognized instead over the number of years it takes to construct the building.

There are limited instances under PSAS where the province would be permitted to recognize the funds as revenue over the 50-year life of the building, and some of the transfers received by the government are correctly accounted for in this manner.

OUR AUDIT OPINION ON THE SUMMARY FINANCIAL STATEMENTS

For example, if government received the funds to build a bridge, but the transferor had designated in the transfer agreement that some of the funds were for maintaining the bridge over its useful life, in that case government could recognize the funds so designated as revenue over the life of the bridge.

This issue first came up in 2013 when the current PSAS standard on accounting for government transfers became effective. At that time, government should have adjusted all of the funds received in prior years that had been deferred, and which under the new standard should not be deferred any longer. Because it did not make that correction, the total amount as of March 31, 2015, which should not be deferred, is $4.2 billion. But most of that should have been adjusted in prior years, so the amount that current year revenue is understated by for 2014/2015 is $191 million.

THE NEW PSAS STANDARD FOR REMEDIATION OF CONTAMINATED SITES

WHAT IS THE CONTAMINATED SITES LIABILITY?

The contaminated sites liability is the cost to clean up contamination exceeding relevant environmental standards arising from past development and industrial activity at sites that are no longer in productive use.

As per Note 27(b), of the Summary Financial Statements, sites include mostly abandoned mines, but also transportation infrastructure, industrial sites, pulp mills and other miscellaneous sites.

Taxpayers fund clean-up costs only if private parties no longer exist that would accept responsibility for clean up and the site has defaulted to the government, or if the site poses an immediate, unacceptably high risk to human health or the environment. Exhibit 8 shows the location of these sites in B.C.

WHAT HAS CHANGED IN THE SUMMARY FINANCIAL STATEMENTS?

More information is available about the type and amount of liabilities

Previously, government only reported the estimated cost to clean up assessed contaminated sites. Now, government reports additional information, including:

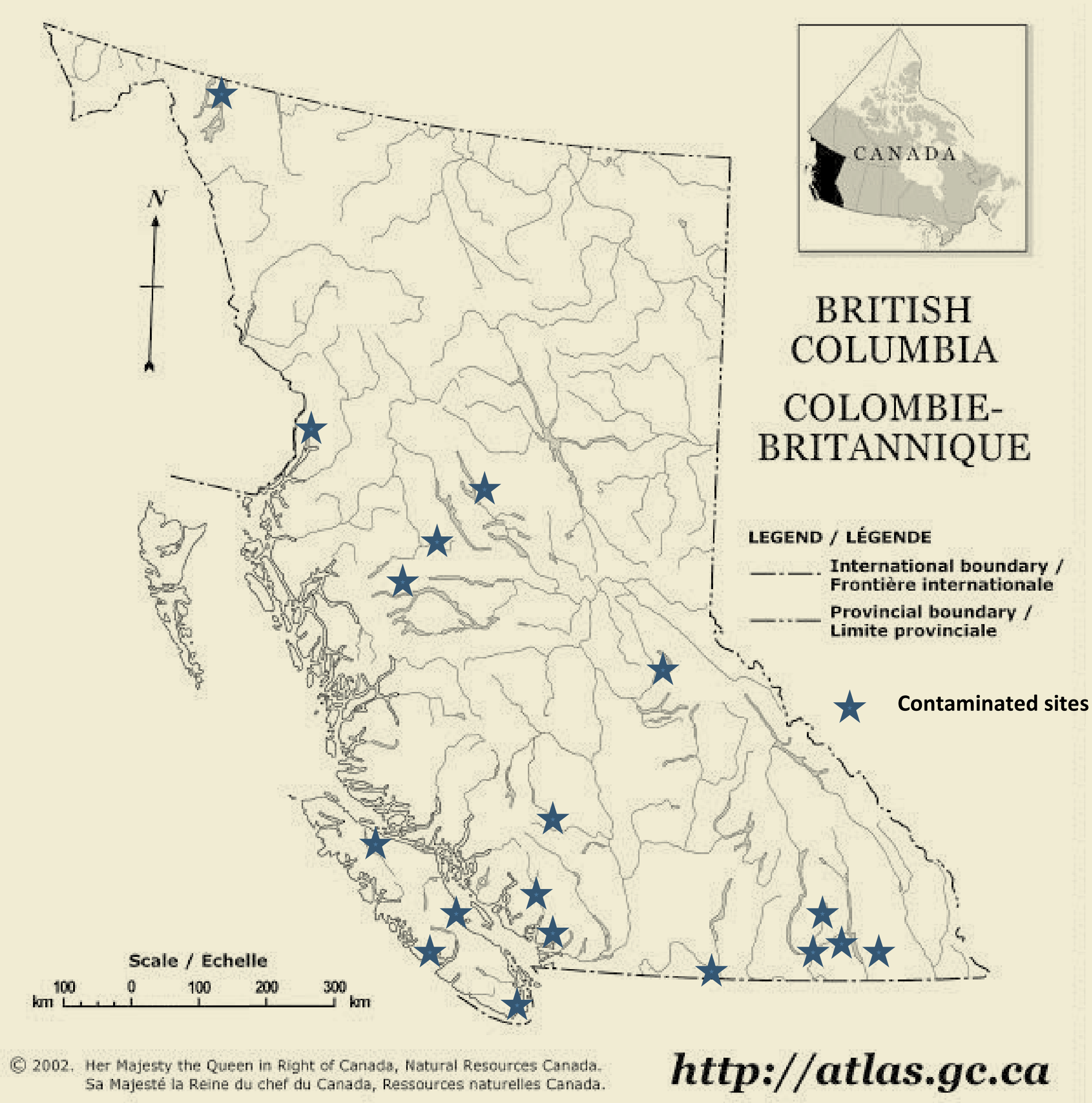
- the types of site
- remediation costs by type of site
- estimated costs for any required ongoing remediation, monitoring and maintenance

The new standard means a more complete estimate of remediation liabilities

Previously, government's environmental liability financial statement note was based only on the minimum estimated clean–up costs for sites where government had determined it was liable and had made an estimate of the costs.

THE NEW PSAS STANDARD FOR REMEDIATION OF CONTAMINATED SITES

Exhibit 8: BC's contaminated sites – symbols can represent more than one site



THE NEW PSAS STANDARD FOR REMEDIATION OF CONTAMINATED SITES

This meant any resource constraints (in funding or staffing) in performing site assessments would delay the recording of a liability. Although this understated the total liability, it was compliant with the previous PSAS standard.

For 2014/2015, there is more assurance around the completeness of the liability for contaminated sites, as it now also includes an estimate for those sites where government has not yet conducted an assessment. However, due to the process of estimating the liability, there is disclosure about the high degree of measurement uncertainty in note 2 of the Summary Financial Statements.

Liability estimates and reporting only includes sites not deemed to be in *productive use*

The latest standard introduces a new concept that improves the liability disclosure – the concept of whether or not sites are in *productive use*. The standard does not define this term, but it is generally understood to mean sites that are being used for operations. This distinction impacts how remediation liabilities are recorded.

The following table illustrates the accounting impact of whether or not a contaminated site is deemed to be in productive use. This is only one criterion to determine how to account for a contaminated site, and it assumes the other criteria (such as government being responsible), have been met.

Source of contaminated site no longer in productive use	Accounting impact
Government operation no longer in productive use	Record a liability for remediation.
Private sector operation no longer in productive use	No impact unless government accepts responsibility to remediate. If so, then a liability for remediation will be recorded.

Previously, the environmental clean-up financial statement note stated: "the Ministry of Energy and Mines has determined possible net liabilities of approximately $1.3 billion for sites the province does not own." Under the new standard, government is not required to disclose this information, as these are outside of the government reporting entity and are still deemed in productive use.

This does not mean that there is never a liability for sites that are in productive use. If a site in productive use unexpectedly becomes contaminated beyond acceptable legal limits, it needs to be cleaned up, and an estimate of the costs to clean it up would be set up as a normal operating liability. In some cases, if the site operation is expected to cause contamination that will require remediation, government would record a liability as part of the initial costs of the site. This is called an asset retirement obligation.

THE NEW PSAS STANDARD FOR REMEDIATION OF CONTAMINATED SITES

Government now discloses contingent liabilities for environmental remediation

In instances where it is uncertain whether government may be responsible for remediating a contaminated site, government may disclose a contingent liability. Government may also disclose a *contingent liability* when it cannot make a reasonable estimate of the amount or when there is no expectation that government will pay for site remediation. In both of these cases, disclosure would also be required to explain why this is the case. As disclosed in Note 27(b) to the financial statements, the future cost of these sites is not currently determinable.

CONTAMINATED SITES: WHY IS THERE A NEW ACCOUNTING STANDARD?

The PSAB decided there was a need to issue new guidance related to liabilities for environmental remediation of contamination to ensure financial statements provide relevant and reliable information, and to promote better uniformity and consistency when applying existing standards.

HOW GOVERNMENT IMPLEMENTED THE NEW STANDARD

Prior to the new standard, government already recorded liabilities for environmental remediation costs, but only where assessments of these contaminated sites had been made. The new standard is much broader, requiring government to determine if these liabilities exist on all sites where contamination exists, regardless of whether it has made assessments or not.

To do this, government used a number of techniques. These included assessing historical and current information, such as the nature of past activities, site locations, and hydrological and geological characteristics. Similarities to, and experience at, other known contaminated sites and their significance were also considered, so government could conclude which sites were likely contaminated, and record an estimated liability for remediation. Government recorded a liability of $397 million for 2014/2015, which is an increase of $273 million because of the new standard.

BC Hydro and BC Rail also record environmental remediation liabilities, which together total $460 million. However, these two entities follow IFRS, and the adoption of the new PSAS standard has no impact on the amount they record. These amounts are included as disclosure only, in Note 27(b) of the Summary Financial Statements.

THE NEW PSAS STANDARD FOR REMEDIATION OF CONTAMINATED SITES

OUR CONCLUSION ABOUT THE IMPLEMENTATION

We concluded that government's estimated liability for its contaminated sites was within a reasonable range. There were, however, opportunities for improvements, including estimating costs of clean-up, and better documentation of those costs, which we have shared with government.

LOOKING AHEAD
– NEW CANADIAN PUBLIC SECTOR ACCOUNTING STANDARDS

Over the next few years, beginning with fiscal 2018, eight new Canadian public sector accounting standards could impact the Summary Financial Statements.

- For the year ending on March 31, 2018, government will need to adopt amendments made in the Introduction to the Public Sector Accounting Handbook, and new rules for accounting and disclosure related to five other areas: related parties, assets, contingent assets, contractual rights and inter-entity transactions.
- For the year ending on March 31, 2019, the Province will need to adopt new rules for accounting and disclosure related to restructuring transactions.
- For the year ending on March 31, 2020, the Province will need to adopt new rules for accounting and disclosure related to financial instruments.

We have advised government that early analysis of the upcoming new reporting standards is prudent and we will work with them through this process. Below are examples of additional disclosure these upcoming standards will require in the Summary Financial Statements.

- Government will need to disclose information about material related party transactions when they occur at a value different from that which would have been arrived at if the parties were unrelated.
- Government will need to disclose information about contingent assets. This is a new concept to public sector accounting. Contingent assets can arise when there is a current situation that will be resolved in the future, but where the resolution is outside government's control. The outcome or resolution will confirm whether an asset exists. For example, when government is involved in a lawsuit, the future confirming event or the resolution of the lawsuit, is not within their control, but they may feel it is probable that they will be successful and include related disclosures.
- Government will also need to disclose contractual rights, another concept new to public sector accounting. A contractual right arises out of a binding contract or agreement that has clear economic consequences and is enforceable by law, such as the right to receive lease payments.

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