2004/2005: Report 7

OFFICE OF THE

Auditor General of British Columbia

Monitoring the Government's Finances

Province of British Columbia

November 2004

Canadian Cataloguing in Publication Data

British Columbia. Office of the Auditor General.

Annual report — 1994 —

Annual.

Subtitle varies.

Continues: British Columbia. Office of the Auditor General. Annual report to the Legislative Assembly of British Columbia.

Report year ends Mar. 31.

ISSN 1208–7920 = Annual report — British Columbia. Office of the Auditor General

1. Finance, Public – British Columbia – Auditing – Periodicals. 2. British Columbia. Office of the Auditor General – Periodicals. I. Title.

HJ13.B74 352.43'09711 C97–890000–6

OFFICE OF THE
Auditor General
of British Columbia

LOCATION:
8 Bastion Square
Victoria, British Columbia
V8V 1X4

OFFICE HOURS:
Monday to Friday
8:30 a.m. – 4:30 p.m.

TELEPHONE:
250 387–6803
Toll free through Enquiry BC at: 1 800 663–7867
In Vancouver dial 660–2421

FAX: 250 387–1230

E–MAIL: bcauditor@bcauditor.com

WEBSITE:
This report and others are available at our Website, which also contains further information about the Office: http://bcauditor.com

OFFICE OF THE
Auditor General
of British Columbia

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

Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2004/2005 Report 7: Monitoring the Government's Finances.

Wayne Strelioff, FCA
Auditor General

Victoria, British Columbia
November 2004

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

Table of Contents

Auditor General's Comments

Wayne Strelioff, FCA
Auditor General

For several years my Office has encouraged the government of British Columbia to take a lead role in providing, at least annually, a complete analysis of its financial trends and indicators. We believe it is important for legislators and the public to have this information in order to better understand the significant and complex business of government. Through this and previous reports on Monitoring the Government's Finances, my Office has provided such an analysis of government's financial trends and indicators.

I am pleased to report that in its recent Public Accounts, issued in June 2004, the government has included, for the first time, its own discussion and analysis of its financial statements.

This improvement is a significant step. I expect it to lead to a fuller discussion and analysis of major financial decisions, trends and indicators, and in this way help legislators and the public to gain a better understanding of the financial direction the government is taking our province.

Nevertheless, more remains to be done.

An analysis of financial statements is necessary for anyone wanting to understand the government's financial position, however the statements alone are an insufficient means of measuring and explaining the province's overall financial health. And while the financial highlights provided by government are commendable, there are many improvements that can, and should, be made in the information presented.

For example, the British Columbia government has been looking at a number of options for providing public services through "alternative service delivery" approaches. These approaches typically involve the transfer of risks and rewards to corporations outside the government reporting entity.

In 2004, the government was involved in two high profile alternative delivery initiatives: its coastal ferry services and its freight rail services. Changes such as these have a significant effect on government finances because they alter the nature of the government's business. Monitoring government's finances, a key element of accountability, becomes more important than ever in a period of such change. To gain, and hold, the confidence of legislators and the public, the government should provide an explanation of the significant transactions that may affect its financial health and its ability to continue providing the services it has promised its citizens it will.

The Public Sector Accounting Board of the Canadian Institute of Chartered Accountants (PSAB) provides recommended practices for the provision of financial statement discussion and analysis. The recommendations propose that governments:

- Include financial statement discussion and analysis (FSD&A) in an annual report together with the Summary Financial Statements. The FSD&A should be referenced to the related Summary Financial Statements.
- Include an acknowledgment by government that it is responsible for the preparation and content of the information.
- Communicate information embodying the basic characteristics of financial statement information—understandability, relevance, reliability and validity, and comparability.
- Include a concise summary of the significant events affecting the financial statements.
- Include information on significant risks and uncertainties underlying the financial statements, and an outline of the strategies, policies and techniques adopted to manage them.
- Identify and explain significant annual variances. This could include year-to-year or budget-to-actual variances.
- Include an analysis of trends related to the elements of the financial statements. This could include a trend analysis of financial assets, liabilities, net liabilities, tangible capital assets, revenues, expenses, and cash flows.

In this report, we provide an analysis of financial trends and indicators for the last eight years. We track a number of basic economic indicators, using credible sources, including the government's audited financial statements. However there are a number of PSAB recommendations which we could not provide, including an assessment of the government's future milestones and projections. These should be provided by the government when it reports on its finances publicly.

Overall Picture

In the year ended March 31, 2004, British Columbia incurred an annual deficit of $1 billion. This is the result of a $2.9 billion deficit in the general programs of government, offset by a $1.9 billion surplus in government business enterprises. The annual deficit is better than planned by approximately $0.7 billion, and is an improvement over the 2003 deficit of $3 billion.

The government's financial trends in various areas over the last eight years are shown in Exhibit 1.

The overall accumulated deficit at the end of March 2004 totalled $4.7 billion (compared to $3.7 billion in 2003). This means that the current and future citizens of British Columbia carry $27 billion of net liabilities ($26 billion in 2003) against which they own infrastructure assets with a depreciated value of $22.3 billion ($22.3 billion in 2003).

Over the last four years the government's ratio of net liabilities to Gross Domestic Product has increased from 16% to 19%, although there was a slight decrease during 2004. The increasing trend means that the overall burden on future taxpayers has increased.

In its first quarterly report of 2004/05, the government is forecasting much improvement. However, I have not included that in my analysis as the forecast is unaudited.

How did we do in comparison with the rest of Canada? In 2003/04, British Columbia's economy, as measured by the percentage increase in GDP, performed about the same as Canada's, while Alberta, Saskatchewan, Newfoundland and Labrador, New Brunswick, and Nova Scotia did better.

In 2003/04, British Columbia's GDP per capita continued to be below Canada's average. British Columbia again ranked fifth amongst the provinces in that measure, behind Alberta, Ontario, Saskatchewan and Newfoundland and Labrador.

According to Moody's Investors Services all the provinces in the country maintained their credit rating during the year ending March 31, 2004. Moody's still regards British Columbia as the second lowest credit risk of all provinces in Canada, after Alberta. Manitoba's and Ontario's credit ratings are equal to that of British Columbia.

Exhibit 1

Financial Information Framework, 1997 to 2004

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

Revenue and Expense
For the Years Ended March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002	2003	2004
General programs								
Revenue	22,630	23,048	22,940	24,677	27,243	27,608	25,258	26,601
Expense	23,942	25,009	25,405	25,818	27,488	29,753	30,028	29,484
	(1,312)	(1,961)	(2,465)	(1,141)	(245)	(2,145)	(4,770)	(2,883)
Enterprises								
Revenue	7,884	8,284	9,434	10,380	14,496	13,149	11,468	12,081
Expense	6,809	6,958	7,914	9,088	12,771	12,064	9,702	10,200
	1,075	1,326	1,520	1,292	1,725	1,085	1,766	1,881
Annual surplus/(deficit)	**(237)**	**(635)**	**(945)**	**151**	**1,480**	**(1,060)**	**(3,004)**	**(1,002)**

Assets and Liabilities
As At March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002	2003	2004
General programs								
Financial assets	6,419	6,795	7,018	9,288	9,182	9,186	8,017	9,239
Liabilities	28,651	29,737	31,011	33,828	33,796	35,290	37,015	39,388
	(22,232)	(22,942)	(23,993)	(24,540)	(24,614)	(26,104)	(28,998)	(30,149)
Enterprises								
Assets	17,760	18,439	19,299	18,814	19,387	18,669	18,960	19,612
Liabilities	14,819	15,267	16,013	15,655	15,964	15,765	15,929	16,459
	2,941	3,172	3,286	3,159	3,423	2,904	3,031	3,153
Net liabilities	**(19,291)**	**(19,770)**	**(20,707)**	**(21,381)**	**(21,191)**	**(23,200)**	**(25,967)**	**(26,996)**
General infrastructure assets	19,563	19,407	19,399	20,224	21,514	22,463	22,226	22,253
Accumulated deficit	**272**	**(363)**	**(1,308)**	**(1,157)**	**323**	**(737)**	**(3,741)**	**(4,743)**

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Crown corporation financial statements

Auditor General's Comments

I wish to thank officials of the Government of British Columbia and of my counterparts in other Canadian jurisdictions who assisted me by providing information and explanations I needed to produce this report. I also wish to acknowledge the hard work, professionalism and dedication of my staff who helped me with this work.

Wayne K. Strelioff, FCA
Auditor General

Victoria, British Columbia
November 2004

Project Team:

Senior Principal: Keyvan Ahmadi

Director: Peter Bourne

Project Leader: Randy Nicholson

Glossary

Glossary

Accumulated surplus/deficit	The total of all past annual surpluses and deficits to date.
Annual surplus/deficit	The difference between the government's annual revenues and expenses.
Business enterprises	Also known as commercial, self-supporting or modified equity enterprises. These are self-sufficient Crown corporations that sell goods or services to parties outside the government reporting entity.
CICA	The Canadian Institute of Chartered Accountants.
Derivative contract	A "swap" or other financial instrument that is entered into with a third party, and is used to hedge interest rate, foreign currency or other risk exposures.
Federal transfers	Funds received by a province from the federal government, such as the Canada Health and Social Transfer (CHST) and Equalization payments.
Financial assets	Assets of government (such as cash, investments, loans and accounts receivable) that can be converted to cash in order to pay government's liabilities or finance its future operations. Financial assets also include the government's investments in its business enterprises.
General infrastructure assets	Tangible physical assets used by the government to provide general program services to citizens.
Generally accepted accounting principles (GAAP)	This refers to the accounting principles that government should follow in order to be consistent in its accounting practices with similar organizations. The authority for GAAP is the CICA.
General programs	Those activities of government that are supported by taxpayers.
Government reporting entity	The group of organizations that are consolidated in the government's Summary Financial Statements.
Gross domestic product (GDP)	The money value of goods and services produced within a geographical boundary. It can be reported without adjusting for inflation (known as market value, current or nominal GDP) or it may be discounted for the effects of inflation (real GDP). In this report, GDP is not adjusted for inflation.

Glossary

Hedging	Reducing potential exposure to foreign currency, interest rate or other risks. Often achieved by entering into derivative contracts with a third party.
Net liabilities	A government's total liabilities less its financial assets. This is the residual liability amount that will have to be paid or financed by future taxpayers. Also referred to as "net debt."
PSAB	Public Sector Accounting Board of the CICA. This board recommends accounting principles for Canadian governments.
Public debt	Borrowings of the government. Debt generally consists of debentures, notes payable, capital leases and mortgages.
Public debt charges	Also known as the cost of borrowing, or debt servicing costs, this is the interest incurred by the government on its borrowings.
Revenue-generating assets	The assets of government business enterprises. These are termed revenue-generating as the assets are used in the operations of self-supporting business enterprises.
SUCH sector	Refers to School districts, Universities, Colleges and Health authorities.
Summary Financial Statements	The consolidated financial statements through which the government reports its financial position and operating results.

Part 1:
Financial Measures and Trends in British Columbia

Part 1: Financial Measures and Trends in British Columbia

Why we write this report

Governments, like families and businesses, must regularly review their financial position to keep track of their sources of money, of the costs of doing what they do, of the value of assets they need, and of the size of their debt. Likewise, they must monitor their financial condition to determine their ability to continue their programs, make new economic decisions and deal with uncertainties as they move forward. Without this important monitoring, governments may find it difficult to put into place the complex organization necessary to provide all of the many services they promised to their citizens.

Governments choose different types of organizations to bring goods and services to the public. The selected organizational structure depends on the governing party's strategic direction, the government's legislative mandates and the established public policies.

Some public programs, such as K-12 education in British Columbia, are almost fully funded by the general revenues of government. These are "general programs."

Other services are provided by organizations that are expected to stand on their own. These organizations sell their goods or services directly to the general public—BC Hydro and the Liquor Distribution Branch are two examples. These are "enterprises," or profit-making businesses, that may also have a significant duty to take care of some aspect of the public good.

Governments pay particular attention to these two service delivery types. General programs are also referred to as taxpayer-supported programs, and enterprises as self-supported organizations. The mix of these types and the scope of their operations give governments flexibility in implementing their policies. They are the first of the series of lenses through which governments monitor their finances.

The British Columbia government monitors closely the operations of its taxpayer- and self-supported activities. In its financial plans and the summary financial statements, for example, it combines all its taxpayer-supported activities together line by line, and then adds to them the net results of its commercial enterprises. It also publishes its debt information according to whether the borrowing was needed for its general programs or its commercial enterprises—the idea being that self-supported commercial enterprises will be able to pay their debt from their own resources, while the general program debts must be repaid from taxes and other general revenue (which, incidentally, includes the net earnings of commercial enterprises).

Recently the government started publishing, in its annual Public Accounts, a limited analysis of its financial condition. We commend the government for taking this important step, and hope this work expands into a fuller commentary by government on the financial activities of both its taxpayer-supported and self-supported types of service delivery. Such commentary would allow legislators and the public to better understand how sustainable government programs are; how the government can deal with future uncertainties, particularly in areas where it is financially vulnerable; and how it can change course with reasonable flexibility to introduce new programs or reduce its dependence on volatile resources.

We write this report to show how publishing information similar to that presented here is both useful and practical. We believe such information, reported regularly, enhances government's transparency and increases the confidence and trust of the public in the institutions of government.

Monitoring government's finances

In this report we present a financial framework that we believe is necessary if we are to monitor government's finances in a meaningful way.

To create a credible framework, we have used information we are confident in. This includes, for example, audited financial statements, the annual Budgets and Estimates, and reports published by credible third-party agencies. We have also adhered to the following key financial reporting principles:

1. **Completeness** – We use a financial framework that provides a full view of all financial operations of government.
2. **Relevance** – We provide trends and indicators that complement, as well as supplement, financial statements.

3. **Significance** – We present important information covering the range of services provided by government from the perspective of the burden on taxpayers.
4. **Understandability** – We look beyond internal accounting adjustments and related party transfers that, in our view, make explaining the government's finances difficult.

We organized the financial framework to present financial information of the general programs and commercial enterprises separately. We have taken care in preparing the multi-year financial information to ensure consistency in accounting treatment from year to year, so that a meaningful comparison of financial trends can be made.

To make trends meaningful, we have been building our data base to prepare a 10-year history. We could not yet do this because certain important information has not been easily available, but we now have eight years of information.

Using the eight-year financial information framework, as shown in Exhibit 2, we describe a number of financial trends and indicators for British Columbia, and show how the province compares in some respects to other jurisdictions.

We provide here financial measures and trends for annual revenue, expense, surplus/deficit, assets and liabilities. These are the major financial components of government's financial condition.

We also provide eight-year (and, when possible, 10-year) trends of indicators of financial condition, based on the guidelines for governments published by the Canadian Institute of Chartered Accountants (CICA). As well, we have adhered to the guidance on financial statement discussion and analysis published by the Public Sector Accounting Board (PSAB) of the CICA.

Unfortunately, the 2004 Public Accounts of provinces other than Alberta, Saskatchewan, Ontario and Nova Scotia have not been available on time for us to use their latest financial information in this report. Also, several provinces do not report on their complete reporting entity, or have a reporting entity that is different in nature than that of British Columbia. For these reasons we are limited to only three widely used indicators to compare our province's overall financial performance to that of other provinces.

Exhibit 2

Detailed Financial Information Framework, 1997 to 2004

Revenue and Expense
For the Years Ended March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002	2003	2004
General programs								
Revenue								
Taxation	13,463	13,551	13,620	13,796	14,329	14,136	12,331	13,808
Natural resources	2,671	2,681	2,015	2,821	4,181	3,263	3,281	3,653
Federal transfers	2,296	2,165	2,527	3,109	3,285	3,310	3,815	3,619
Other	4,200	4,651	4,778	4,951	5,448	5,435	5,831	5,521
Unusual items	–	–	–	–	–	1,464	–	–
	22,630	23,048	22,940	24,677	27,243	27,608	25,258	26,601
Expense								
Health	7,456	7,820	8,102	8,683	9,291	10,414	11,036	11,171
Education	6,447	6,526	6,533	6,709	7,269	7,811	7,907	8,069
Social services	3,099	3,181	3,146	3,115	3,263	3,442	3,145	2,845
Interest	1,712	1,636	1,769	1,876	1,971	1,808	1,693	1,719
Other	5,228	5,846	5,855	5,435	5,642	5,931	5,735	5,557
Unusual items	–	–	–	–	52	347	512	123
	23,942	25,009	25,405	25,818	27,488	29,753	30,028	29,484
	(1,312)	(1,961)	(2,465)	(1,141)	(245)	(2,145)	(4,770)	(2,883)
Enterprises								
Revenue								
BC Hydro	2,403	2,533	3,018	3,458	7,889	6,311	4,407	4,477
Insurance Corporation of BC	2,624	2,690	2,822	2,966	2,872	2,971	3,023	3,300
BC Liquor Distribution Branch	1,543	1,598	1,645	1,671	1,732	1,798	1,890	2,004
BC Lottery Corporation	867	942	1,261	1,402	1,483	1,607	1,792	1,890
BC Railway Company	421	427	418	479	496	440	304	374
Other	26	94	270	404	24	22	52	36
	7,884	8,284	9,434	10,380	14,496	13,149	11,468	12,081
Expense								
BC Hydro	2,064	2,125	2,622	2,912	7,340	6,053	4,018	4,400
Insurance Corporation of BC	2,779	2,676	2,761	2,776	2,886	3,213	2,943	2,998
BC Liquor Distribution Branch	956	992	1,029	1,054	1,090	1,161	1,236	1,280
BC Lottery Corporation	595	652	806	870	921	1,001	1,121	1,162
BC Railway Company	385	387	391	1,062	502	606	300	323
Other	30	126	305	414	32	30	84	37
	6,809	6,958	7,914	9,088	12,771	12,064	9,702	10,200
	1,075	1,326	1,520	1,292	1,725	1,085	1,766	1,881
Total annual surplus/(deficit)	**(237)**	**(635)**	**(945)**	**151**	**1,480**	**(1,060)**	**(3,004)**	**(1,002)**

Assets and Liabilities
As At March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002	2003	2004
General programs								
Financial assets	6,419	6,795	7,018	9,288	9,182	9,186	8,017	9,239
Liabilities	28,651	29,737	31,011	33,828	33,796	35,290	37,015	39,388
	(22,232)	(22,942)	(23,993)	(24,540)	(24,614)	(26,104)	(28,998)	(30,149)
Enterprises								
Assets								
BC Hydro	10,462	10,392	10,716	10,617	11,467	10,892	10,887	10,825
Insurance Corporation of BC	5,263	5,630	5,957	5,974	5,909	5,821	6,189	6,899
BC Liquor Distribution Branch	89	84	91	92	111	125	153	134
BC Lottery Corporation	100	137	164	160	147	160	185	184
BC Railway Company	1,647	1,759	1,920	1,387	1,372	1,233	1,111	1,129
Other	199	437	451	584	381	438	435	441
	17,760	18,439	19,299	18,814	19,387	18,669	18,960	19,612
Liabilities								
BC Hydro	8,981	8,726	8,962	8,648	9,354	8,891	8,917	9,098
Insurance Corporation of BC	5,053	5,406	5,672	5,499	5,428	5,582	5,870	6,281
BC Liquor Distribution Branch	89	84	91	92	111	125	153	134
BC Lottery Corporation	85	95	89	86	104	110	127	113
BC Railway Company	515	590	765	852	846	866	740	707
Other	96	366	434	478	121	191	122	126
	14,819	15,267	16,013	15,655	15,964	15,765	15,929	16,459
	2,941	3,172	3,286	3,159	3,423	2,904	3,031	3,153
Net liabilities	**(19,291)**	**(19,770)**	**(20,707)**	**(21,381)**	**(21,191)**	**(23,200)**	**(25,967)**	**(26,996)**
General infrastructure assets	19,563	19,407	19,399	20,224	21,514	22,463	22,226	22,253
Accumulated surplus/(deficit)	**272**	**(363)**	**(1,308)**	**(1,157)**	**323**	**(737)**	**(3,741)**	**(4,743)**

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Crown corporation financial statements

Admittedly, the reporting model we present has some shortcomings. For instance, it does not contain a discussion of future milestones and projections, or a year to year comparison of planned results to actual results. These elements we would expect the government to include when it moves—as we encourage it to do—to preparing such a full report.

Our Reporting Model

The Summary Financial Statements are a general-purpose financial reporting tool. They are prepared in a fixed format following strict accounting principles that allow only the net result of commercial enterprises to be included. A primary difference between the Summary Financial Statements and the reporting model we are using in this report is that we capture details of all economic activities of the government, irrespective of the organizational form in which they take place. We include the detailed revenues, expenses, assets and liabilities of all government, including schools, universities, colleges and hospitals, as well as of commercial enterprises.

The financial framework we present is a specially designed data-base put together to facilitate complete financial analysis. As well as summarizing financial data we also include information about population and GDP. We have included a wide range of details so that trends can be developed on all measures consistently. The financial framework is therefore not meant to be a set of financial statements or to replace the Summary Financial Statements.

We have not tried to produce a financial statement discussion and analysis that meets all the qualitative characteristics of PSAB's guidelines. In our view, such a complete analysis is best left to government to do. In Appendix A of this report, however, we have reproduced the "Financial Statement Discussion and Analysis Report" section of the 2004 Public Accounts.

In Part 1 of this report, we present British Columbia's trends in financial measures and indicators.

In Part 2, we compare British Columbia with other Canadian jurisdictions by looking at the changing trends in three main indicators of the government's overall fiscal performance.

Part 1: Financial Measures and Trends in British Columbia

Unless otherwise noted, in this report a particular year refers to the fiscal year ending in that year. For example, 2004 refers to the fiscal year 2003/04 which runs from April 1, 2003 to March 31, 2004.

In this report we also make use of statistical and economic data supplied to us by Statistics Canada. Our convention in using this data is similar to the government in its reporting of the key indicators of provincial debt in its Public Accounts. Population data for a fiscal year is the population as at July 1 of the fiscal year. Gross domestic product and consumer price index data for a fiscal year are the amounts for the calendar year which ends in the fiscal year.

In addition, unless otherwise noted, all financial data used in this report is based on that presented in the framework in Exhibit 2.

Revenue Trends

Exhibit 3 shows the government's revenue sources from general programs and commercial enterprises. Between 2003 and 2004, total revenue increased by $2.0 billion. This is the first increase in revenue after two consecutive years of decline. From 1997 to 2000, total revenue had shown a general increase. During 2001 and 2002 government revenues increased greatly—benefitting from unusually large sales of hydro-electric power. In 2003 these sales returned to normal. Overall, between 1997 and 2004, the government's total annual revenue has risen from $30.5 billion to $38.7 billion, an increase of 27%.

Exhibit 3

Government Revenue, 1997 to 2004

Government revenue by main source ($ Billions)

	1997	1998	1999	2000	2001	2002	2003	2004
General programs								
Taxation	13.4	13.5	13.6	13.8	14.3	14.1	12.3	13.8
Natural resources	2.7	2.7	2.0	2.8	4.2	3.3	3.3	3.7
Federal transfer	2.3	2.2	2.5	3.1	3.3	3.3	3.8	3.6
Other	4.2	4.6	4.8	5.0	5.4	6.9	5.8	5.5
	22.6	23.0	22.9	24.7	27.2	27.6	25.2	26.6
Enterprises	7.9	8.3	9.4	10.4	14.5	13.2	11.5	12.1
Total revenue	**30.5**	**31.3**	**32.3**	**35.1**	**41.7**	**40.8**	**36.7**	**38.7**

Source: Office of the Auditor General of British Columbia

Exhibit 3 also shows the revenue from general programs broken down into its components of taxation, natural resources, federal transfers and other sources.

Revenue from taxes and from business enterprises are the two most significant sources of revenue for the government. In 2004, each source represented about one-third of the total revenue.

Similar to the trend in total revenue, taxation revenue increased from $13.4 billion in 1997 to $14.3 billion in 2001, dropped to $14.1 billion in 2002 and to $12.3 billion in 2003, then rebounded in 2004 to $13.8 billion—the same level as in the year 2000. The most significant change between 2003 and 2004 was an increase in personal income taxation revenue of $0.7 billion.

Between 1997 and 2001 revenue from commercial enterprises increased, from $7.9 billion to $14.5 billion. As noted above, there were significant increases in energy sales by BC Hydro in 2001 and 2002. In 2002 and 2003 revenue declined, but in 2004 revenue again increased.

In addition to BC Hydro, other government commercial enterprises include the BC Liquor Distribution Branch, BC Lottery Corporation, BC Railway Company and the Insurance Corporation of British Columbia.

The $0.2 billion decrease in federal transfer revenue between 2003 and 2004 is mainly the result of an increase in Canada Health and Social Transfer funding of $0.4 billion, offset by the requirement to transfer back to the federal government an overpayment of Equalization program revenue of $0.9 billion.

Government business enterprises are Crown corporations that do not ordinarily need financial assistance from general revenue of the government to operate. Included in the revenue of these enterprises for 2004 is $1.1 billion (2003: $1.3 billion) related to hedging transactions. A similar amount is included in enterprise expenses. These transactions are mainly forward contracts and derivative instruments related to the purchase and sale of energy. Because of a change in accounting policy beginning in 2003, BC Hydro has netted these amounts. To maintain consistency of the basis of ratios presented in this report, we have not netted them.

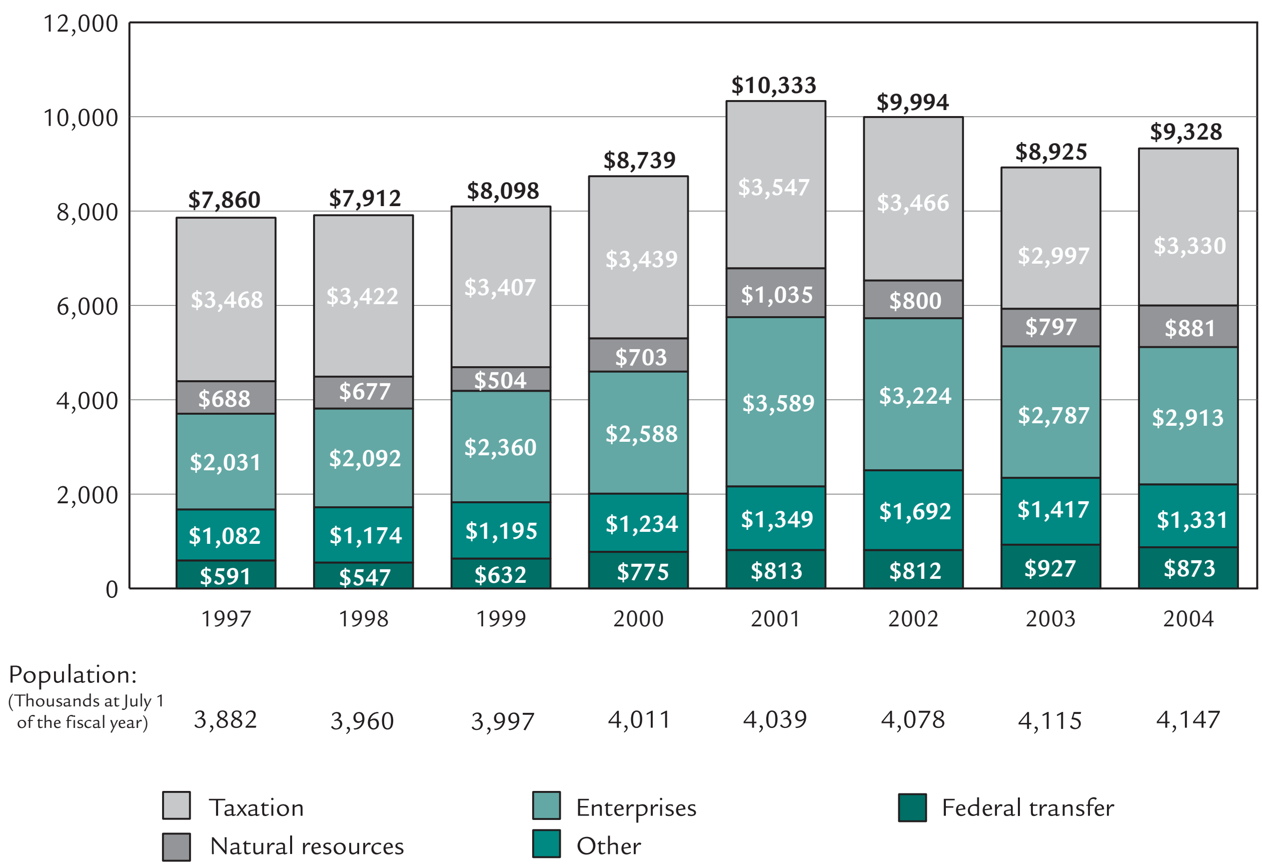
The $0.4 billion increase in natural resource revenue is attributed to a significant increase in permit fee and royalty revenue for petroleum and natural gas, offset by a decrease in forestry revenue.

Exhibit 4 shows the revenue per capita for each of the four general program revenue categories and for revenue from commercial enterprises. Overall, per capita government revenue increased 19%, from $7,860 in 1997 to $9,328 in 2004.

Exhibit 4

Per Capita Revenue, 1997 to 2004

Per capita revenue by main source over the past eight years ($)



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

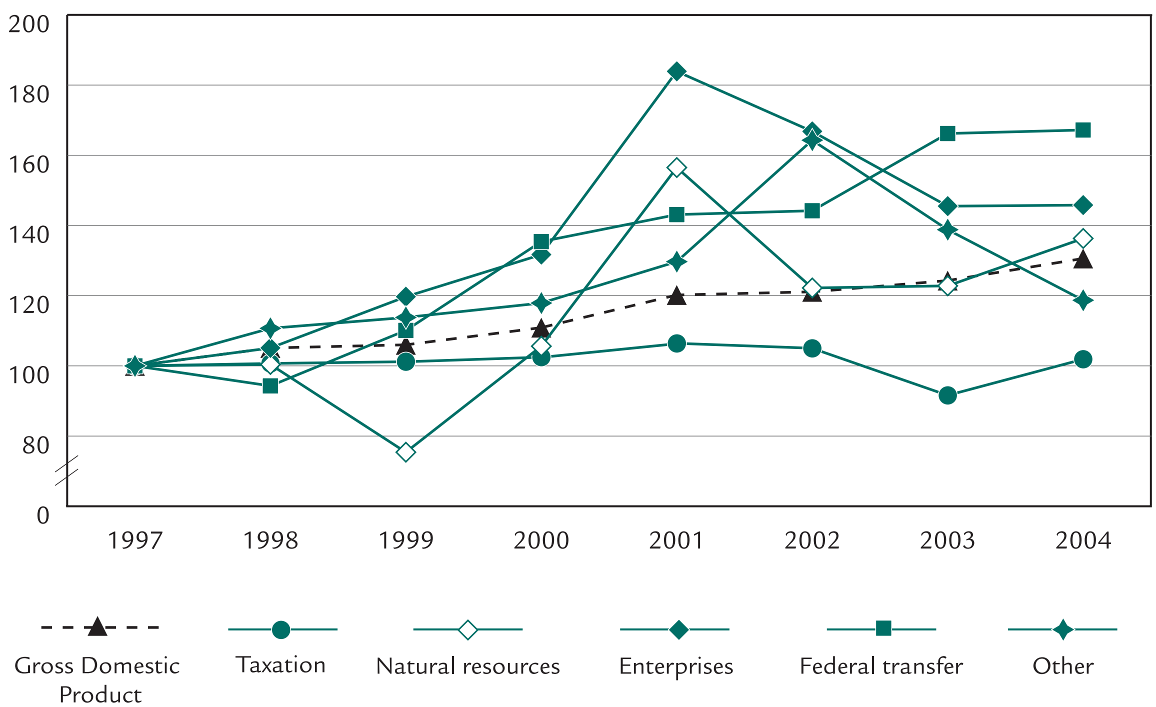
Exhibit 5 shows the rate of change in revenue over the last eight years by each of the revenue components, compared with the increase in the province's Gross Domestic Product. The base year in this exhibit is 1997. For each year that follows, the dollars of revenue for each component are shown as a percentage of the revenue in 1997. For example, in 1999 natural resources revenue was less than 80 percent of the natural resources revenue in 1997.

The trend in taxation revenue shows slight increases between 1997 and 2002, and a large decline in 2003. This is the result of lower estimates of personal income tax revenue, due mainly to decreases in personal income tax rates. There was a resurgence of revenue in 2004, owing mainly to increases in the estimate of personal income tax revenue for the current and prior years.

Exhibit 5

Change in Revenue, 1997 to 2004

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



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

Natural resources has been the most volatile of revenue sources. Natural resources revenue declined sharply in 1999 mainly because of decreases in forest-related revenues. It then increased significantly in 2000 and 2001 because of higher oil and natural gas prices that spurred higher royalty sales of Crown land drilling rights, only to decline again in 2002 as natural gas prices and sales revenue of downstream hydro-electric benefits fell. As noted above, 2004 saw an increase in petroleum and natural gas revenue.

Revenue generated from commercial enterprises increased sharply in 2001 because of higher energy prices that increased BC Hydro's sales revenues significantly.

Federal transfer revenue has continued to increase because of larger Canada Health and Social Transfer payments being provided to all provinces.

"Other" revenue shows a large one-time increase in 2002, resulting from gains made from the settlement of pension plans.

Expense Trends

Exhibit 6 shows the annual expenses incurred by government, for general programs and enterprises, from 1997 to 2004.

Exhibit 6

Government Expense, 1997 to 2004

Government expense by main component ($ Billions)

	1997	1998	1999	2000	2001	2002	2003	2004
General programs								
Health	7.5	7.8	8.1	8.7	9.3	10.4	11.0	11.2
Education	6.4	6.5	6.5	6.7	7.3	7.8	7.9	8.1
Social services	3.1	3.2	3.1	3.1	3.2	3.5	3.2	2.8
Interest	1.7	1.6	1.8	1.9	2.0	1.8	1.7	1.7
Other	5.2	5.9	5.9	5.4	5.7	6.3	6.2	5.7
	23.9	25.0	25.4	25.8	27.5	29.8	30.0	29.5
Enterprises	6.8	7.0	7.9	9.1	12.8	12.1	9.7	10.2
Total expense	**30.7**	**32.0**	**33.3**	**34.9**	**40.3**	**41.9**	**39.7**	**39.7**

Source: Office of the Auditor General of British Columbia

Total government expenses increased from $30.7 billion in 1997 to $39.7 billion in 2004, an increase of 29%. Health, education and social services combined account for over 50% of the total expenses of the province—and this percentage is rising. Health costs have increased the most of any expense category since 1997.

The interest costs reported in Exhibit 6 relate only to the interest cost of general programs, or taxpayer-supported, debt. To arrive at the total interest costs for government, we would need to add the interest expense of enterprises. For 2004, the general programs interest expense is $1.7 billion and the total interest expense is $2.2 billion.

Although general program debt has increased from $21.1 billion in 1997 to $29.9 billion in 2004 (an increase of 42%) the related interest expense in 2004 is the same as it was in 1997 —$1.7 billion. The reason for this is the general decline in interest rates over the last eight years.

The “other” expense includes the cost of restructuring the general programs of government, being $123 million in 2004 ($172 million in 2003). These are shown as unusual items in Exhibit 2. Fiscal year 2004 is the third and final year of a three-year restructuring plan by government.

The expenses of enterprises have increased significantly over the last eight years—from $6.8 billion in 1997 to $10.2 billion in 2004 (see shaded box on page 20).

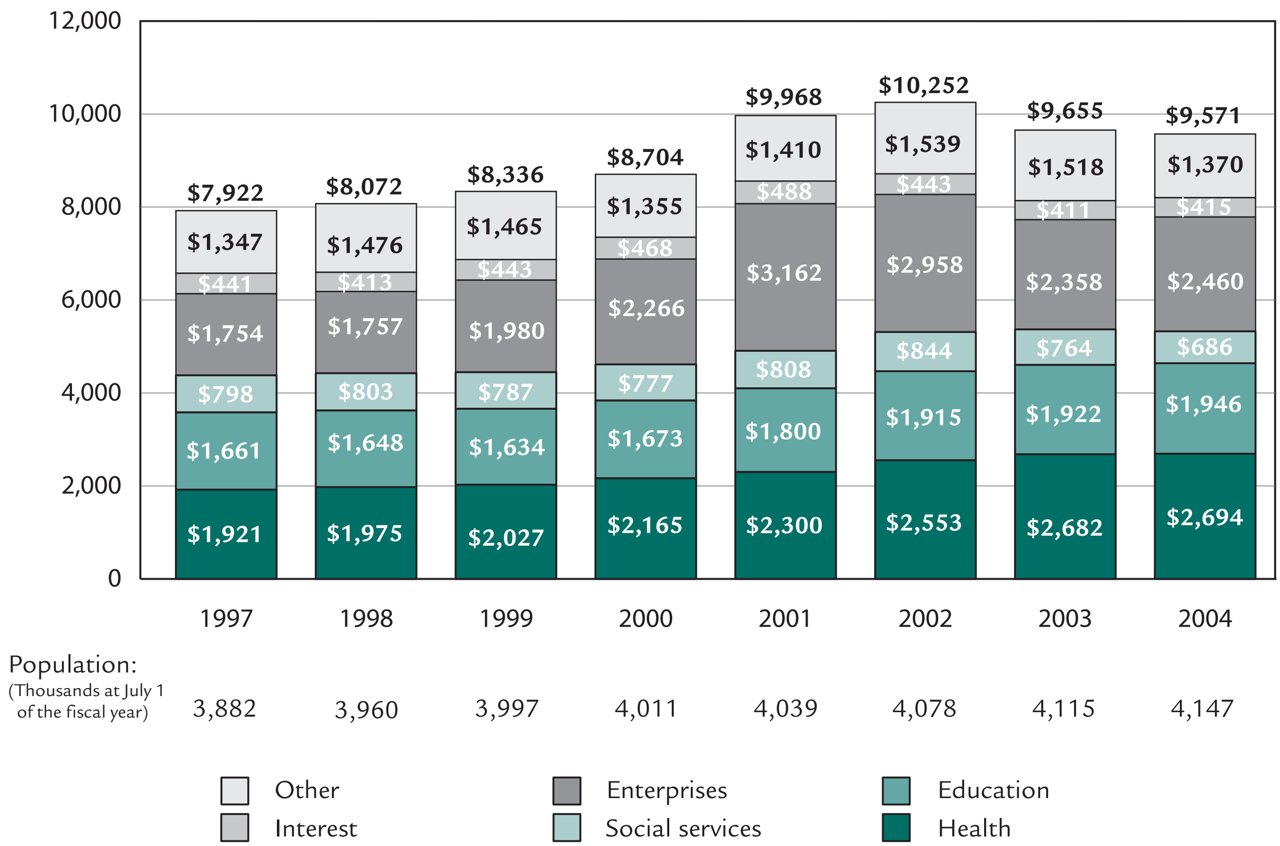
The $3.7 billion increase between 2000 and 2001 was largely attributable to BC Hydro’s operations. The cost of electricity purchased by BC Hydro for resale made up a significant part of this increased expense in the government’s commercial enterprises. These higher costs are matched by the higher revenues reported by BC Hydro for energy sales. In 2002 and 2003, the commercial enterprises expenses decreased, largely because of a decrease in BC Hydro’s energy purchase costs (and energy sales) during those years.

Exhibit 7 shows the government's per capita expenses for the last eight years, by expense category. Overall, per capita government expense increased by 21%, from $7,922 in 1997 to $9,571 in 2004. The largest per capita increase was in health and enterprises expenses, an increase of 40% over the last eight years. Per capita social services expenses have decreased 14% over the same period.

Exhibit 7

Per Capita Expense, 1997 to 2004

Per capita expense by main component over the past eight years ($)



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

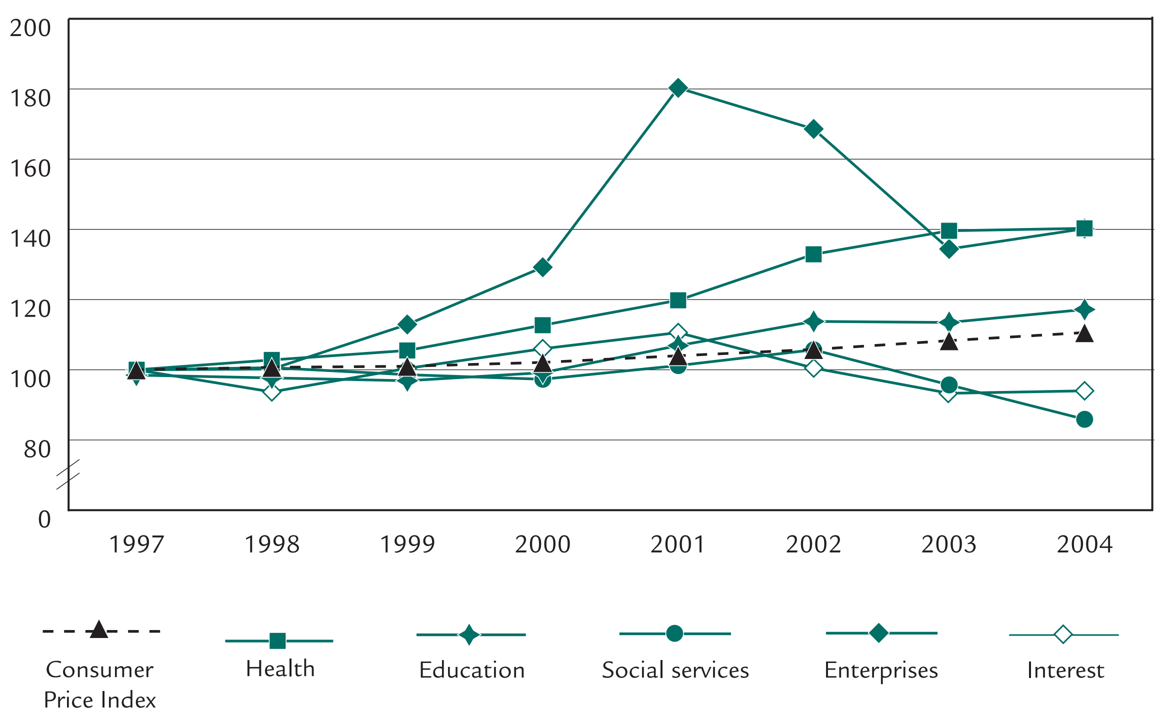
Exhibit 8 shows the rate of change in per capita expenses over the last eight years for health, education, social services, interest and enterprises. To show the change over the past eight years, the per capita expense in each category has been indexed to that expense in the year 1997. The expense is in actual dollars and has not been adjusted for inflation. However, the British Columbia Consumer Price Index (CPI) is plotted to show the general increase in prices in the province (also indexed to 1997) for comparison.

Relative to the Consumer Price Index, spending per capita for health has increased significantly over the last eight years. Per capita spending on education initially declined, but has increased in the last several years; and per capita spending on social services has decreased significantly over the last two years.

Exhibit 8

Change in Per Capita Expense, 1997 to 2004

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



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

Annual Surplus/Deficit Trend

Exhibit 9 shows the trend in annual surplus/deficit for the province. A surplus occurs when annual revenues exceed expenses. A deficit occurs when expenses exceed revenues.

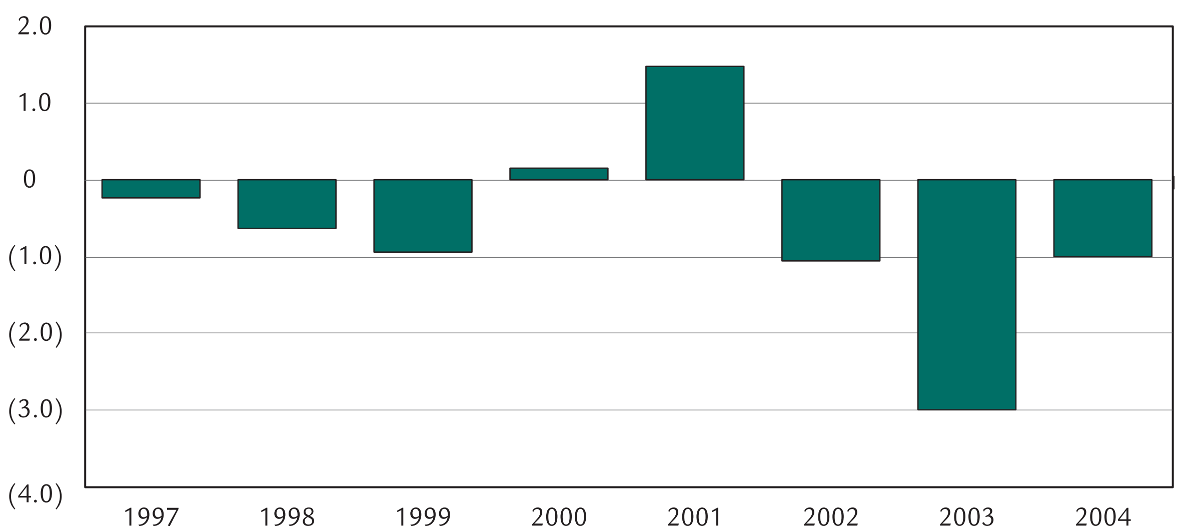
Between 1997 and 1999, the province recorded annual deficits ranging from $0.2 to $0.9 billion. In 2000 and 2001, there were surpluses of $0.2 and $1.5 billion, respectively. And between 2002 and 2004, the province had deficits of $1.1 billion, $3.0 billion and $1.0 billion, respectively.

The 2002 deficit included two unusual items: revenue from the settlement of pension plans of $1.5 billion, and government restructuring expenses of $0.5 billion. Without these unusual transactions, the deficit for 2002 would have been $2.1 billion rather than $1.1 billion.

Exhibit 9

Annual Surplus/(Deficit), 1997 to 2004

The annual surplus/(deficit) ($ Billions)



Source: Office of the Auditor General of British Columbia

Asset Trends

Government assets are grouped according to their use and can be considered either financial or non-financial in nature. Financial assets are cash, investments, inventories, loans and other types of receivables. They are generally converted to cash in the normal cycle of events (for example, loans are converted to cash when collected). Financial assets also include the investments held by government in its enterprises.

Non-financial assets include physical (or "tangible") capital assets that the government has paid for or acquired by trading for other assets. They are not normally converted to cash. Physical capital assets are recorded in the government's financial statements at their net book value (cost less depreciation). They exclude Crown land, forests and other natural resources that belong to the Crown.

Assets are also characterized as being either "infrastructure" or "revenue-generating." Physical capital assets used in the government's general programs are not considered to be revenue-generating assets, even though they may generate some direct revenue. They are considered part of the infrastructure needed to serve the public. Those assets used in government enterprises (such as railways, trains, hydro-electric dams and transmission lines) are expected to generate sufficient revenue to cover the cost of the enterprise's operations.

The distinction between revenue-generating capital assets and infrastructure assets is important because, unless an alternative service delivery is secured, a government does not generally pay off its debt by selling the infrastructure assets needed to serve citizens.

Exhibit 10 presents an overview of the categories of government assets: financial, infrastructure and revenue-generating. It also shows the value of all physical capital assets owned by the government. This is the sum of the general program infrastructure capital assets and the capital assets of business enterprises.

From 1997 to 2004, the government's total assets increased from $43.8 billion to $51.1 billion, an eight-year growth of $7.3 billion, or 17%. Increases in physical capital assets accounted for approximately 40% of this change.

Exhibit 10

Assets, 1997 to 2004

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

	1997	1998	1999	2000	2001	2002	2003	2004
General programs								
Financial assets	6.4	6.8	7.0	9.3	9.2	9.2	8.0	9.2
Infrastructure capital assets[1]	19.6	19.4	19.4	20.2	21.5	22.4	22.2	22.3
	26.0	26.2	26.4	29.5	30.7	31.6	30.2	31.5
Enterprises								
Revenue generating financial assets	6.9	7.3	8.0	7.9	8.6	7.8	7.9	8.5
Revenue generating capital assets[1]	10.9	11.1	11.3	10.9	10.8	10.9	11.1	11.1
	17.8	18.4	19.3	18.8	19.4	18.7	19.0	19.6
Total assets	**43.8**	**44.6**	**45.7**	**48.3**	**50.1**	**50.3**	**49.2**	**51.1**
[1]Total physical capital assets	30.5	30.5	30.7	31.1	32.3	33.3	33.3	33.4

Source: Office of the Auditor General of British Columbia

Because of British Columbia's size and geography, the need for capital infrastructure within the province is substantial. In the last eight years, the net book value of infrastructure assets used within government programs (such as hospitals, other health care facilities, schools, post-secondary institutions, roads, ferries, buses and rapid transit) has increased from $19.6 billion to $22.3 billion, a 14% increase.

In the same eight-year period, the value of revenue-generating assets of the government enterprises (such as those used in power generation, transmission and distribution) has increased by 10% from $17.8 billion to $19.6 billion.

In the last eight years the total value of physical capital assets owned by the government, used in both its commercial activities and general programs, has increased by 10% from $30.5 billion to $33.4 billion.

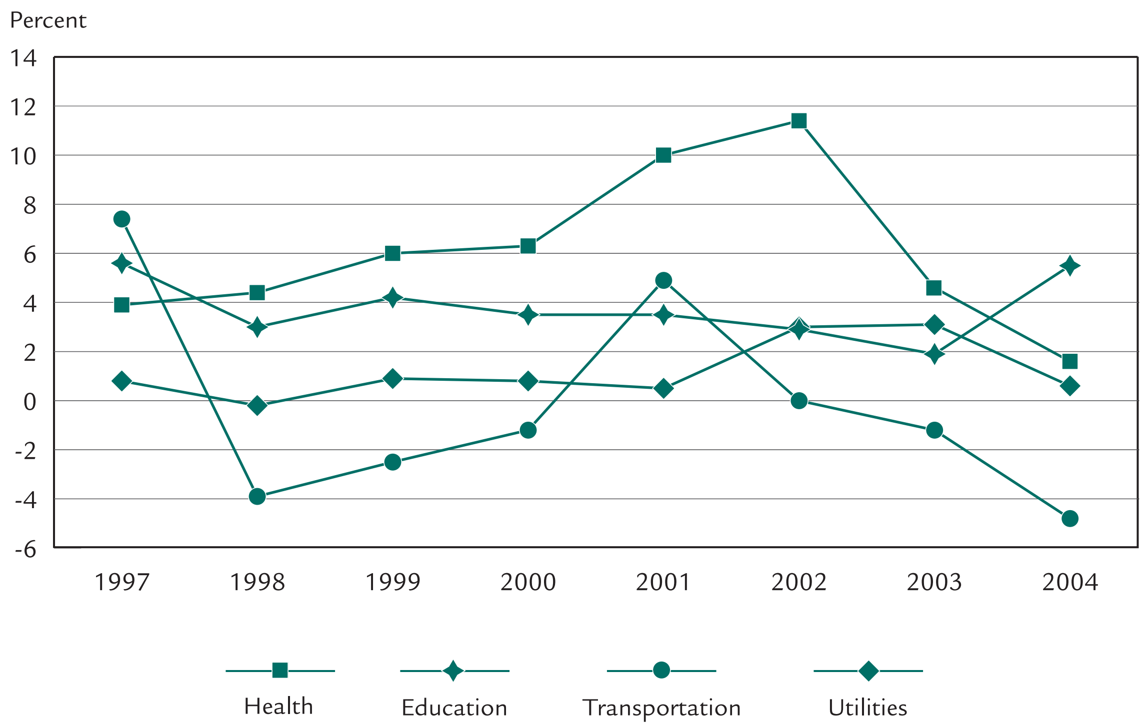
Exhibit 11 shows the percentage change in the net book value of total physical capital assets managed by government and used for health, education, transportation and utilities from 1997 to 2004. The net book value change is the final result after capital additions, disposals and depreciation of the assets are taken into account.

In total, except for a slight decrease in 1998, the net book value of physical capital assets has increased each year. In the transportation sector, however, the book value of assets decreased in 1998, 1999, 2000, 2003 and 2004. In 1998, the government slowed capital spending—in particular that on transportation—to examine its capital investment policy and look for alternative ways to meet

Exhibit 11

Change in Physical Capital Assets, 1997 to 2004

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



Source: Office of the Auditor General of British Columbia

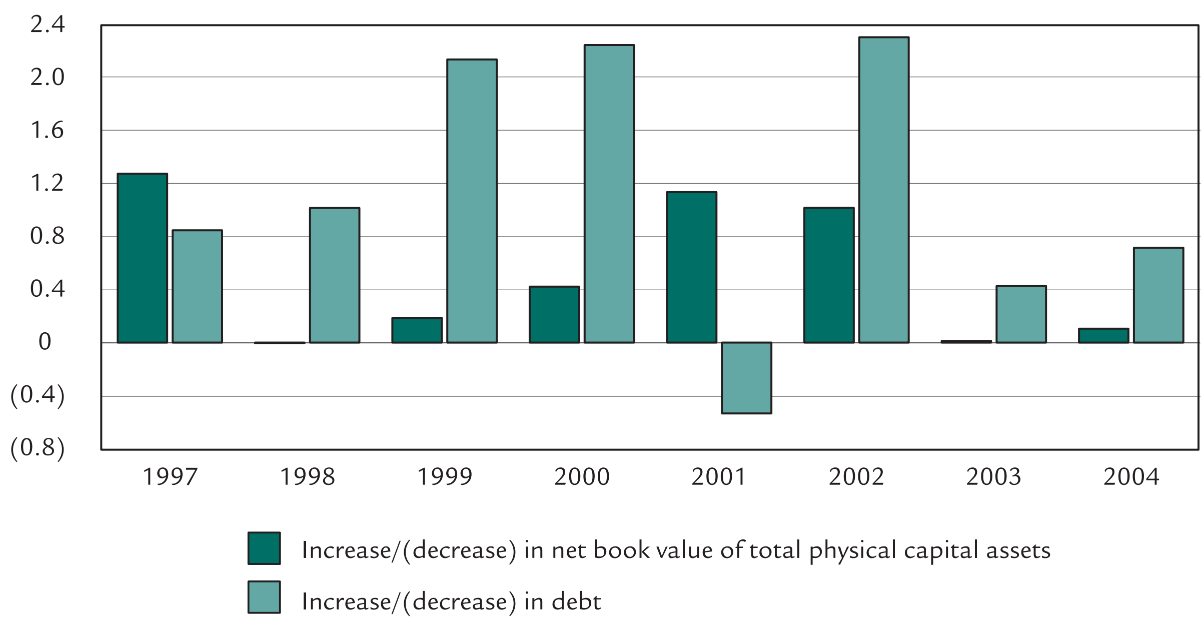
the province's infrastructure needs. The decrease in transportation assets in 2004 reflects the removal of British Columbia Ferry Services Inc. from the government reporting entity.

Government borrows for different reasons: it may do so to finance its operating shortfalls, to build up its stock of capital assets, to finance investment or lending, or simply to ensure that funds are there when needed. Exhibit 12 shows the increase in net book value of the government's total physical capital assets for each of the years 1997 to 2004, compared with the change in total debt each year. This graph provides a picture of how much of the change in debt is being used to provide for capital assets versus other uses of the borrowed funds.

Exhibit 12

Comparing Changes in Capital Assets and Public Debt, 1997 to 2004

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



Source: Office of the Auditor General of British Columbia

Liability Trends

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

Exhibit 13 shows the government's debt and other obligations for the last eight years, by general programs and enterprises. Total debt has increased by $8.3 billion, or 29%, between 1997 and 2004. Between 2003 and 2004 total debt increased by $0.7 billion, or 2%.

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

Exhibit 14 shows the future taxpayers' net liabilities at the end of each of the years 1997 to 2004. Over the eight years, net liabilities increased from $19.3 billion to $27.0 billion, an overall increase of $7.7 billion, or 40%. The largest single increase was during 2003, when net liabilities increased by $2.7 billion.

Exhibit 15 shows the net liabilities on a per capita basis. This shows the amount that each citizen would need to pay in order to discharge government's past borrowing, revenue-generating and spending practices. The net liabilities per capita have increased by 31% over the past eight years. The majority of that increase has come in the last three years.

Monitoring net liabilities—the difference between a government's total liabilities and its financial assets—provides valuable information about the government's financial position. In the next section we discuss the government's financial condition.

Exhibit 13

Liabilities, 1997 to 2004

($ Billions)

	1997	1998	1999	2000	2001	2002	2003	2004
General programs								
Debt	21.1	22.1	23.9	26.5	26.4	28.6	29.2	29.9
Other obligations	7.6	7.6	7.1	7.3	7.4	6.7	7.8	9.5
	28.7	29.7	31.0	33.8	33.8	35.3	37.0	39.4
Enterprises								
Debt	8.0	8.0	8.4	8.0	7.6	7.7	7.5	7.5
Other obligations	6.8	7.3	7.6	7.7	8.4	8.1	8.4	8.9
	14.8	15.3	16.0	15.7	16.0	15.8	15.9	16.4
Total liabilities	**43.5**	**45.0**	**47.0**	**49.5**	**49.8**	**51.1**	**52.9**	**55.8**

Source: Office of the Auditor General of British Columbia

Exhibit 14

Net Liabilities, 1997 to 2004

($ Billions)

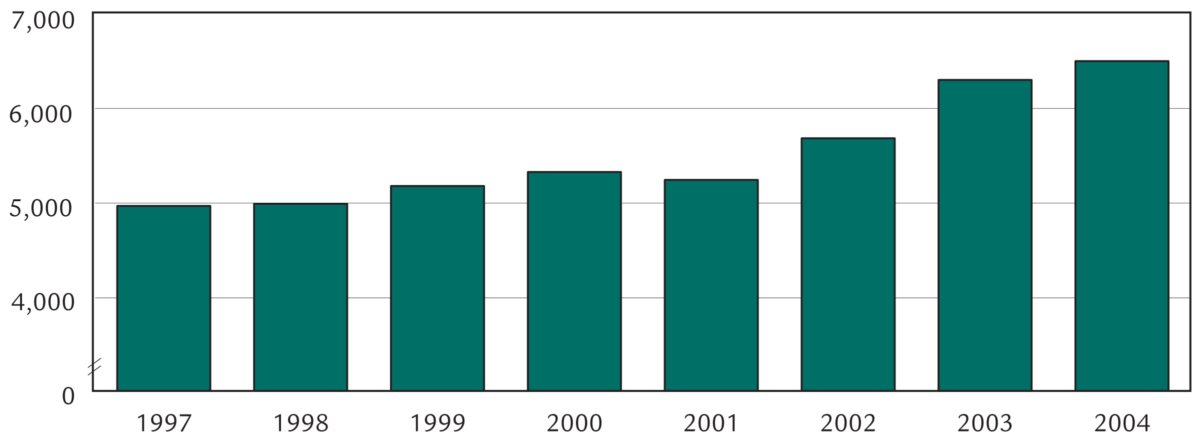
	1997	1998	1999	2000	2001	2002	2003	2004
Total liabilities	43.5	45.0	47.0	49.5	49.8	51.1	52.9	55.8
Less: General program financial assets	6.4	6.8	7.0	9.3	9.2	9.2	8.0	9.2
Enterprise assets	17.8	18.4	19.3	18.8	19.4	18.7	19.0	19.6
Net liabilities	**19.3**	**19.8**	**20.7**	**21.4**	**21.2**	**23.2**	**25.9**	**27.0**

Source: Office of the Auditor General of British Columbia

Exhibit 15

Net Liabilities Per Capita, 1997 to 2004

Net liabilities per capita represents the average financial burden of each citizen of British Columbia ($)



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

CICA Indicators of Financial Condition

In 1997, the Canadian Institute of Chartered Accountants (CICA) published a report titled Indicators of Government Financial Condition. Senior governments and market analysts in Canada have started to use the indicators set out in that report to monitor the financial condition of the federal and provincial governments with respect to the following concepts:

Sustainability—the ability of a government to maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy.

In other words: Can the government continue to raise revenue in order to spend the way it does now?

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

In other words: If the government were to increase its spending, how much room is there in the provincial economy for the government to pay for the spending by increasing either taxes or debt?

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

In other words: Does the government rely too much on revenue from the federal government—revenue that it is unable to control from year to year? Generally, a province can control its taxation policies, but it cannot control the annual transfer of funds from the federal government.

The CICA recommends the reporting of 10 indicators of government financial condition, 7 of which are relevant to provincial governments. These are summarized in Exhibit 16.

Exhibit 16

Indicators of Financial Condition

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

Sustainability indicators:

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

Flexibility indicators:

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

Vulnerability indicators:

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

Source: Canadian Institute of Chartered Accountants

Sustainability Indicators

Two sustainability indicators compare the size of the net liabilities and the annual change in net liabilities with the size of the provincial economy. A stable net liabilities to GDP ratio indicates that the rate of growth in the economy is similar to the rate of growth in the province's net liabilities. An increasing ratio indicates that the government's current fiscal policies are increasing the financial burden on future taxpayers. A declining ratio signals the opposite.

Exhibit 17 shows the eight-year trend of net liabilities to GDP for British Columbia. Up to 2002, the ratio had remained relatively stable, at between 16 and 18%. In 2003, it rose to about 19%. The increasing trend over the last four years means that the overall burden on future taxpayers is increasing.

Exhibit 18 shows the change in net liabilities to GDP ratio in British Columbia for each of the past eight years. There is no "correct" or "optimal" ratio of net liabilities to GDP that a government should aim to achieve. The trend should be examined in conjunction with other financial indicators of the government's finances. The fluctuation in this ratio over the past eight years has been approximately 2% or less.

Flexibility Indicators

The three indicators of government's financial flexibility are:

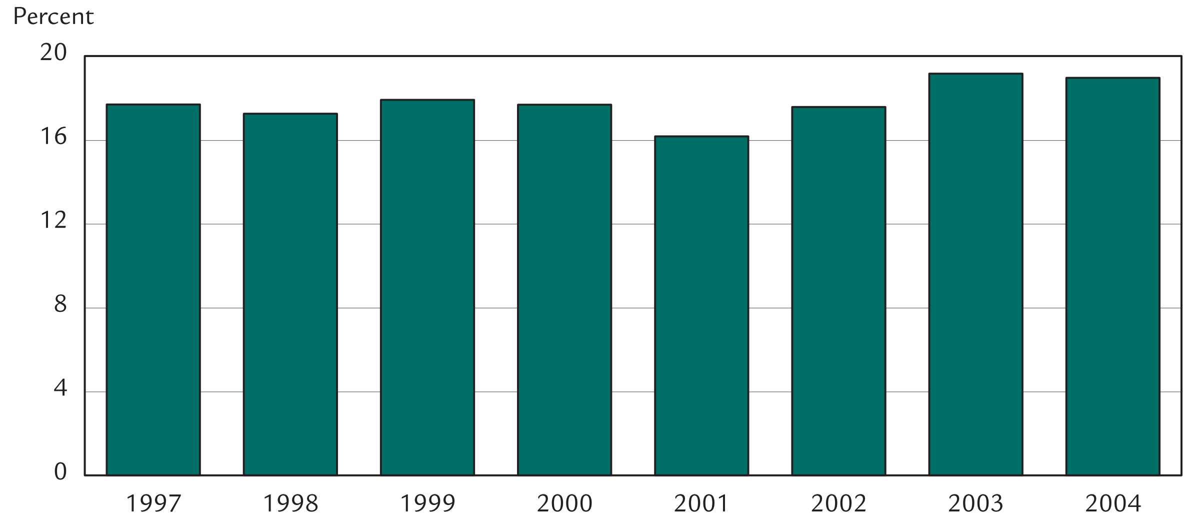
- public debt charges to revenue;
- changes in physical capital stock; and
- own-source revenue to GDP.

The public debt charges to revenue indicator is often referred to as the "interest bite." It shows how much of each dollar of the province's revenue is used to pay interest charges on debt, and it is normally measured in the form of cents per dollar of revenue. If an increasing portion of the revenue of the province is used to pay interest on government debt, then less money would be left to provide services to the citizens of British Columbia.

Exhibit 17

Net Liabilities to Gross Domestic Product (GDP), 1997 to 2004

Net liabilities as a percentage of GDP in British Columbia

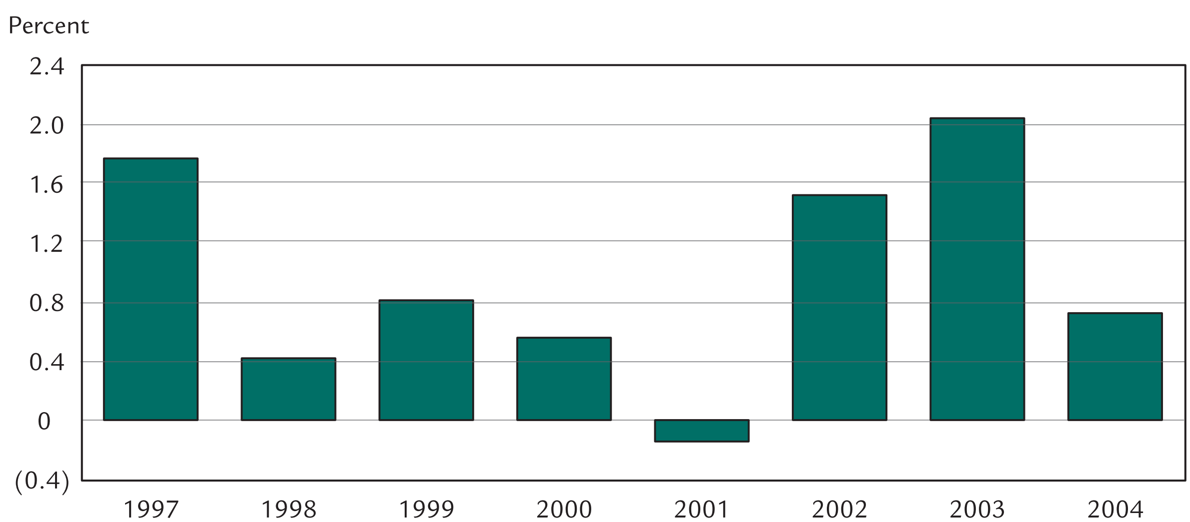


Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 18

Change in Net Liabilities to Gross Domestic Product (GDP), 1997 to 2004

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



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

Exhibit 19 shows the eight-year trend in public debt charges to revenue. The interest bite trend for British Columbia improved between 1997 and 2004. The improvement over the last few years was due mainly to increases in revenue (including substantial increases in hydro-electricity revenues in 2001 and the pension plan settlement gain of $1.5 billion in 2002), concurrent with the relatively flat costs of borrowing as a result of lower interest rates. The debt charges used in this indicator include both the interest expense of government's general programs and the interest included in the expenses of enterprises.

We calculated the interest bite of the province to be approximately 5.8 cents for the 2004 fiscal year. The government reported its interest bite to be 6.3 cents. The difference is explained mainly by the fact that we included in our calculation, as required by GAAP, revenue from schools, universities, colleges and hospitals (the SUCH sector), and the gross revenues of BC Hydro as noted in the shaded box on page 20.

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

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

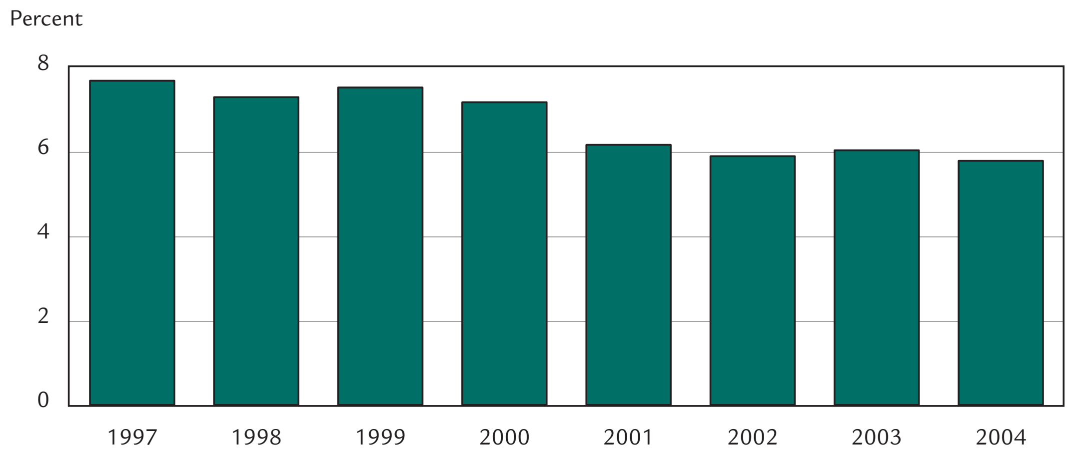
Exhibit 20 shows the annual percentage change in physical capital stock of the provincial government from 1997 to 2004. The graph indicates that the government's capital spending on total physical capital assets was constrained in 1998, but the percentage change has been larger since then. The smaller increases in 2003 and 2004 reflect the write-off of regional hospital district assets, and the removal of British Columbia Ferry Services Inc. from the government reporting entity, respectively.

The ratio of own-source revenue to GDP represents the extent to which the government is taking income from its own economy

Exhibit 19

Public Debt Charges to Revenues (the "Interest Bite"), 1997 to 2004

Total debt interest expense as a percentage of total provincial revenue

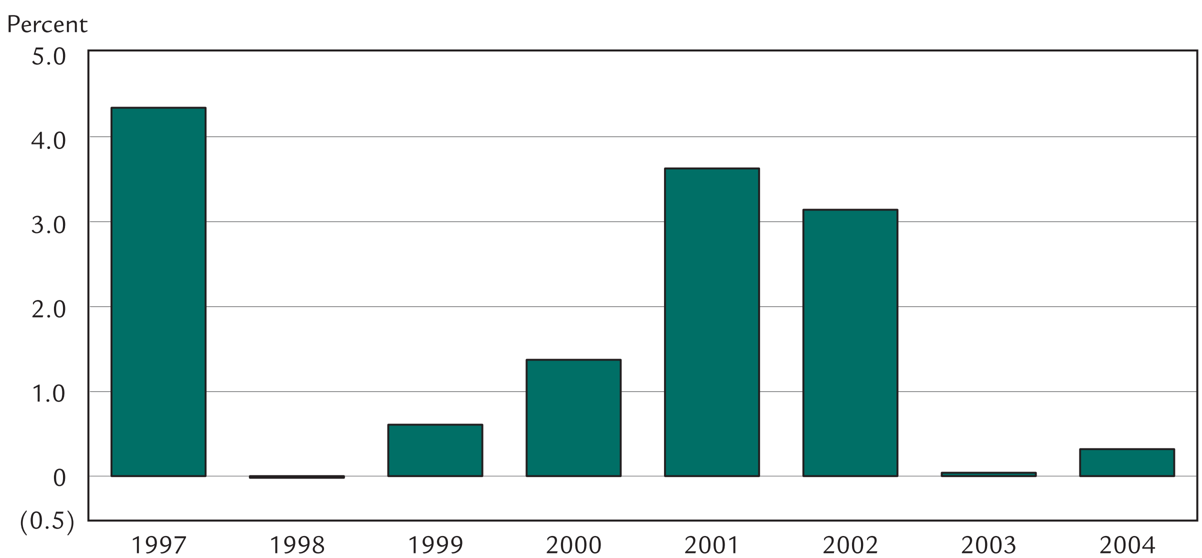


Source: Office of the Auditor General of British Columbia

Exhibit 20

Changes in Physical Capital Stock, 1997 to 2004

Annual percentage change in the net book value of total physical capital assets



Source: Office of the Auditor General of British Columbia

in the form of taxation revenue and other fees. Typically, own-source revenue is all revenue other than federal transfers. This indicator measures the percentage of revenue that a government collects directly from the value of the provincial economy.

Exhibit 21 shows the ratio of own-source revenue to GDP for the eight years 1997 to 2004. The relatively stable trend in this indicator over that time shows that the government has generally obtained its own-source revenue at a similar pace to the growth of the province's economy. The unusually large increase in the own-source revenue to GDP indicator in 2001 and 2002 was due to a large increase in BC Hydro and pension settlement gain revenues in those years. The lower amount in 2003 reflects the decrease in tax revenue in that year.

Vulnerability Indicators

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

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

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

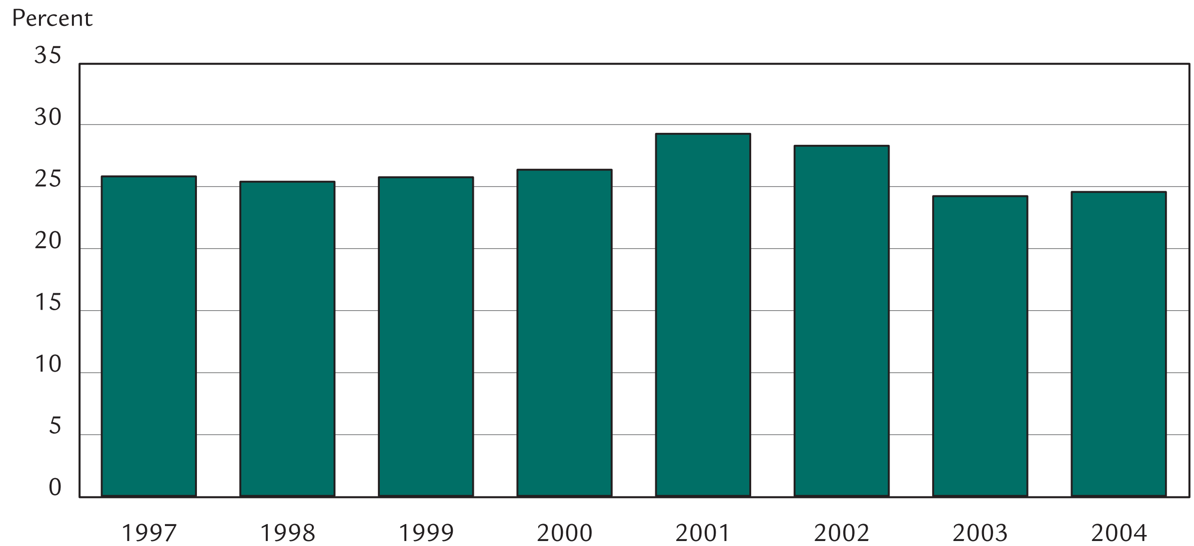
The province receives transfers from the federal government to support the delivery of health, education, social services and other programs. The government-to-government transfers to own-source revenue indicator compares federal government transfers to other provincial sources of revenue. Increases in the ratio may denote a higher dependence on the federal government as a funding source. Because the province does not generally control federal funding decisions, an increase in this ratio would add to the province's financial vulnerability.

Exhibit 22 shows the percentage of government-to-government transfers to own-source revenue for the eight years ending March 31, 2004. The province's dependence on the federal government for funding remained relatively stable until 2002,

Exhibit 21

Own-source Revenue to Gross Domestic Product (GDP), 1997 to 2004

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

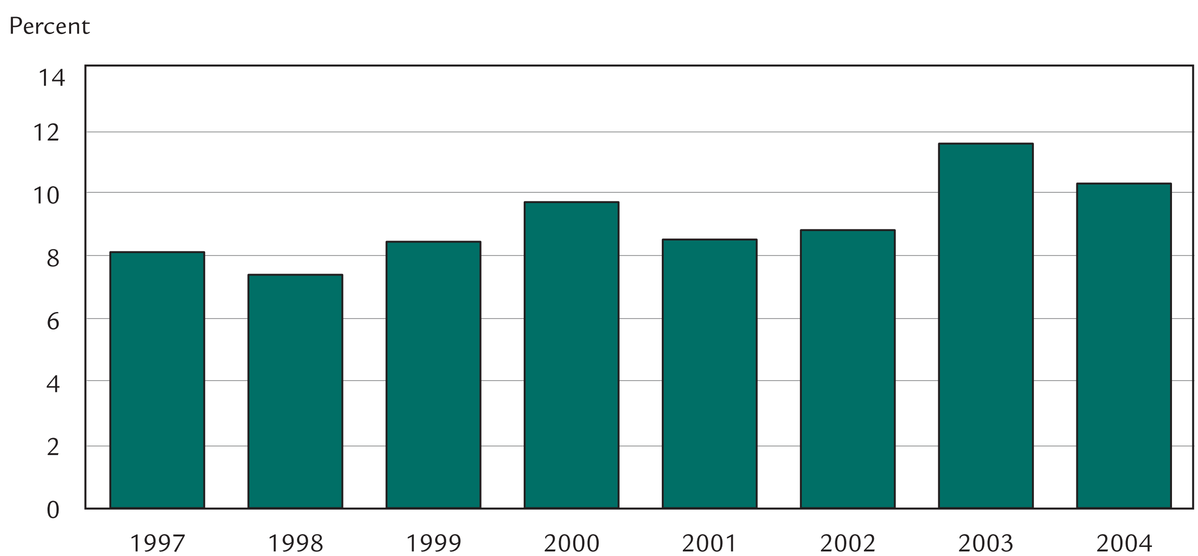


Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 22

Government-to-Government Transfers to Own-source Revenue, 1997 to 2004

Federal transfers as a percentage of all other government revenue



Source: Office of the Auditor General of British Columbia

but has increased over the last two years. In 2003 the province was the recipient of funds through the federal Equalization program—although it has since been determined that the province will likely need to repay that revenue. In 2003 and 2004 the federal government increased payments to British Columbia under the Canada Health and Social Transfer program.

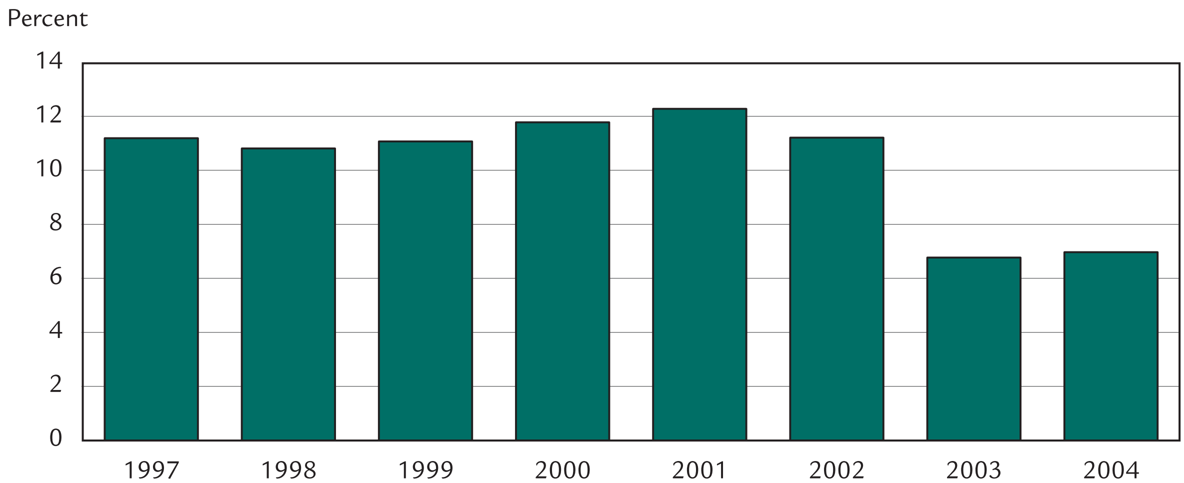
The government of British Columbia often borrows in foreign currencies. To minimize its exposure to swings in these currencies, the government enters into derivative contracts such as currency swaps and forward contracts for most foreign-denominated debt. These contracts ensure that debt repayments are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

The ratio of non-hedged foreign currency debt to total government debt shows the degree of vulnerability of a government's public debt position to swings in foreign currency. Tracking monies borrowed by the government in currencies other than the Canadian dollar is important because of the uncertainties associated with exchange rates when repayment comes due. Exhibit 23 shows that the non-hedged foreign currency debt as a percentage of total government debt decreased during 2003. This was due to a repayment of non-hedged foreign currency debt during the year. There was little change in 2004.

Exhibit 23

Foreign Currency Debt to Total Government Debt, 1997 to 2004

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



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

Part 2:
Comparing British Columbia to Other Canadian Jurisdictions

Part 2: Comparing British Columbia to Other Canadian Jurisdictions

The big picture—where do we stand?

Government can both influence, and be influenced by, changes in the economy. On one hand, government policy can affect the financial and social climate of the province by determining how, and how much, it will collect from and spend on its citizens. On the other hand, taxation, resource and other government revenues are closely tied to the performance of British Columbia's economy. A vibrant economy will normally produce greater revenue for government. Spending that revenue can stimulate economic growth.

In the 2003/04 fiscal year, in comparison with other western Canadian provinces and Ontario, British Columbia experienced moderate inflation, higher unemployment and (with the exception of Manitoba) lower GDP per capita. These results are the same as for the previous fiscal year. Exhibit 24 compares inflation, unemployment and GDP per capita in all western Canadian provinces and Ontario for 2003/04.

There are many financial and statistical indicators available today that allow jurisdictions to be compared with one another. However, comparing provincial statistical and economic information is not without problem. Much work needs to be done to make such comparisons relevant. For instance, statistical and economic information is constantly being updated, and this can result in

Exhibit 24

Economic Indicators for the Western Provinces and Ontario, 2003/04*

British Columbia has higher unemployment, moderate inflation and lower gross domestic product (GDP) per capita

	Inflation %	Unemployment %	GDP per capita $
British Columbia	2.1	8.1	34,342
Alberta	4.4	5.1	54,100
Saskatchewan	2.3	5.6	36,963
Manitoba	1.8	5.0	32,741
Ontario	2.7	7.0	40,318

*Inflation, Unemployment and GDP data is for the calendar year ending December 31, 2003. Population data is as at July 1, 2003.

Source: Statistics Canada

significant changes. It is therefore important to ensure that the date of such information is the same when inter-provincial comparisons are being made.

In addition, the financial information that is produced within each jurisdiction may not be entirely comparable, depending on the accounting policies and reporting entity adopted by each jurisdiction. And, while the absolute dollar value of financial information also makes it difficult to compare provincial finances on a direct basis, the use of ratios and indicators (such as a comparison to GDP or the population) often removes these differences.

In this part of the report, we assess the changes over the last eight years of three significant indicators. These indicators, described below, can provide us with a better understanding of British Columbia's financial performance relative to that of other provinces and the federal government.

Net Liability to GDP

This ratio is used to monitor the fluctuation from year to year of the province's shortage of financial assets to meet its liabilities, compared with changes in the economy. It is a ratio used by all jurisdictions in Canada, and therefore is well established and understood by governments and investors alike. This ratio is also referred to as "net debt to GDP."

In British Columbia the government publishes annually, in the Provincial Debt Summary section of the Public Accounts, the ratio of its public debt to GDP. Monitoring that ratio is also appropriate.

GDP Per Capita

This ratio is used to monitor the year-to-year changes in the province's economy relative to those changes in the economies of other jurisdictions. It is calculated by dividing the nominal GDP for a year by the size of the population. Because many external factors tend to have a similar effect on Canadian jurisdictions, this ratio is also widely used as an indicator of success of a government's fiscal policies. Although GDP per capita is not a complete indicator of citizens' standard of living, it does provide some idea of the programs and services that a province can afford.

Credit Rating

As a service to lenders, credit rating agencies keep watch on changes in the provinces' financial condition and publicly report on them. In the opinion of these agencies, British Columbia has been able to keep its high standing in the international financial market. British Columbia, Manitoba and Ontario share the ranking of second highest-rated province in Canada, after Alberta. British Columbia has maintained a credit rating of Aa2 since 1998.

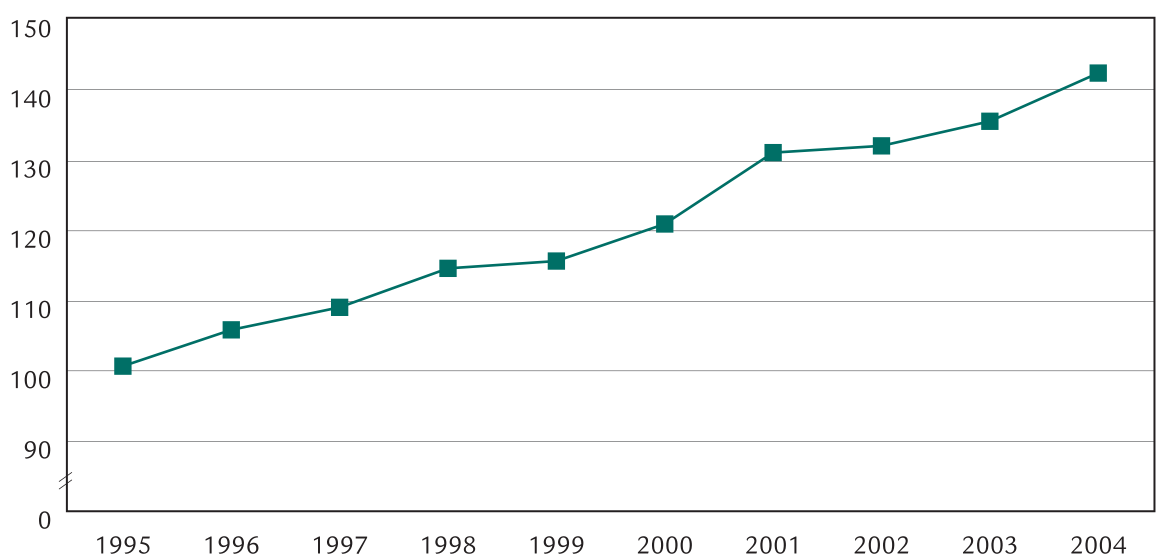
We encourage the government to use these indicators as performance measures of success of its overall fiscal policies.

Exhibit 25 shows the GDP for British Columbia for the 10 years ending in fiscal 2004. The graph shows fairly steady growth in the province's GDP over that time, though growth was a little

Exhibit 25

British Columbia's Gross Domestic Product (GDP), 1995 to 2004*

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



*GDP data is for the calendar year ending in the above fiscal years.

Source: Statistics Canada

flat in fiscal 1999 and 2002. Some of the growth in fiscal 2001 can be attributed to high energy prices. In fiscal 2004, GDP was 5.1% higher than in the previous fiscal year.

Exhibit 26 presents the GDP per capita for British Columbia, Alberta, Ontario, Quebec and Canada as a whole. Appendix B provides the data for these jurisdictions and the six remaining provinces. This information, showing the average output per person for each jurisdiction, is an indicator of the wealth of the province.

Alberta had the highest GDP per capita in fiscal 2004, followed by Ontario and then Canada (the figure for Canada approximates a weighted average of all provinces). British Columbia's GDP per capita remained in fifth position amongst the provinces in 2004, behind Saskatchewan and Newfoundland and Labrador.

In Exhibit 17 on page 37, we presented the net liabilities to GDP indicator for British Columbia for the eight years 1997 through 2004. Net liabilities can also be thought of as the amount that current and past generations of British Columbians are leaving to future generations of citizens to pay or finance. Comparing the net liabilities to GDP makes it easier to compare the net liabilities of one year with another, as well as across different jurisdictions.

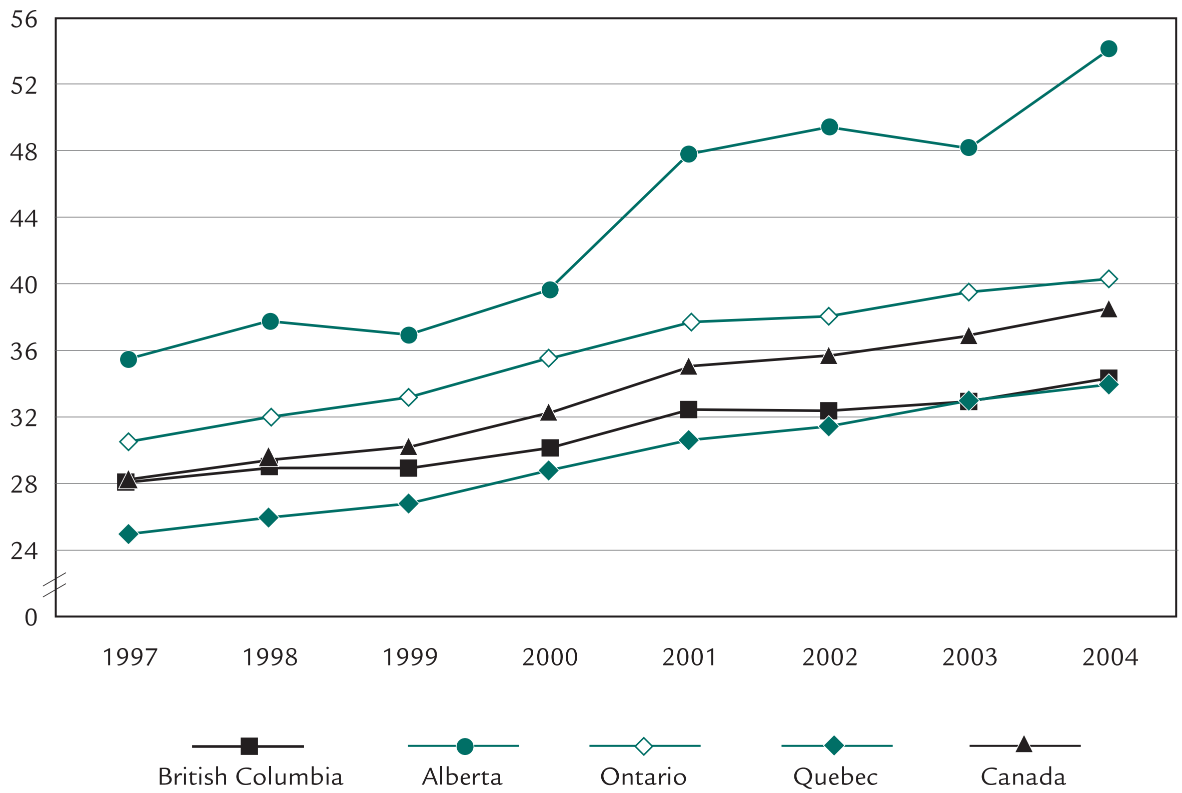
Exhibit 27 presents the net liabilities to GDP for British Columbia, Alberta, Ontario, Quebec and Canada as a whole, for fiscal years since 1997. Appendix C provides the data for these jurisdictions and the six other provinces. The net liabilities for the other jurisdictions is based on information from their Public Accounts, corrected for any misstatements for which there are audit qualifications.

In the graphs in Exhibit 27, a lower liability ratio is better to have than a higher one. Alberta is the only jurisdiction with a "negative" net liability to GDP, and it has been in that position since 2001. This indicates that Alberta has more financial assets than liabilities.

Exhibit 26

Gross Domestic Product (GDP) Per Capita, for Canada and four of the Provinces, 1997 to 2004*

A measure of the financial wealth of a jurisdiction ($ Thousands)



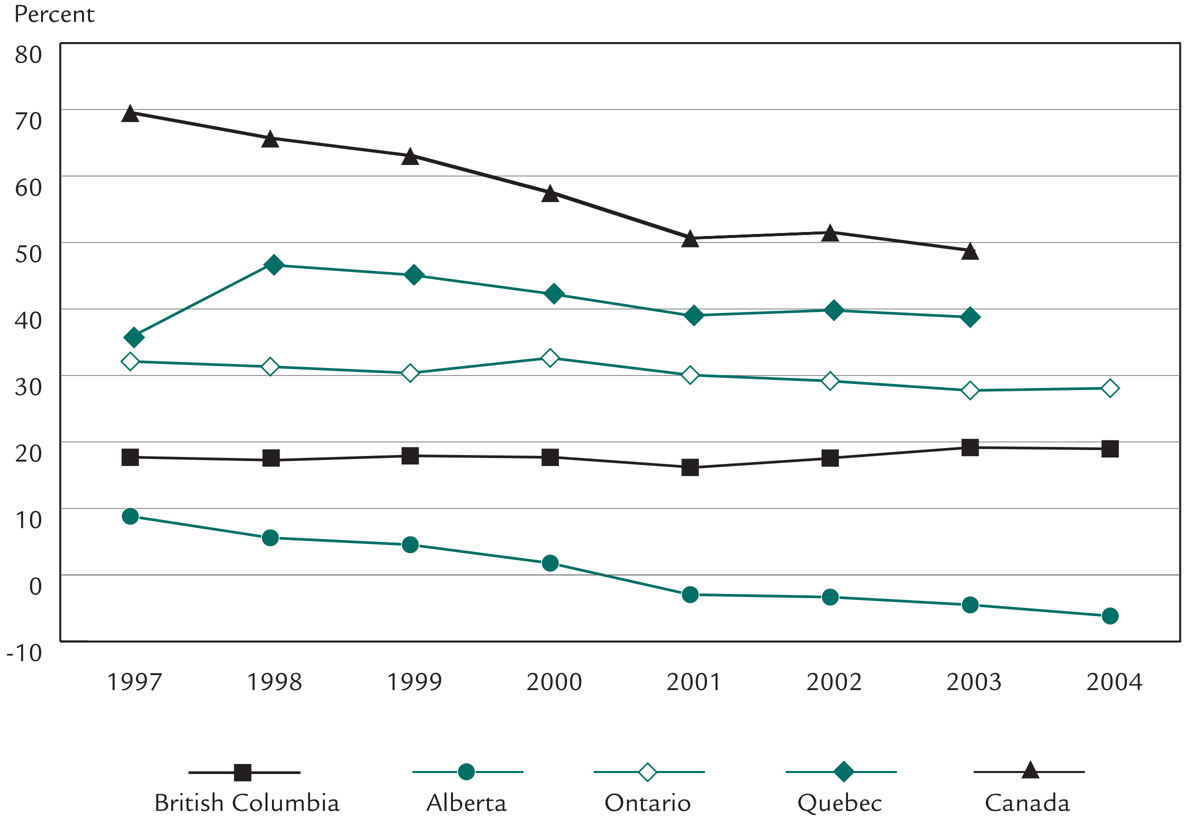
*GDP data is for the calendar year ending in the above fiscal years. Population is as at July 1 of the fiscal year.

Source: Statistics Canada

Exhibit 27

Net Liabilities to Gross Domestic Product (GDP), for Canada and four of the Provinces, 1997 to 2004*

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



*GDP data is for the calendar year ending in the above fiscal years.

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

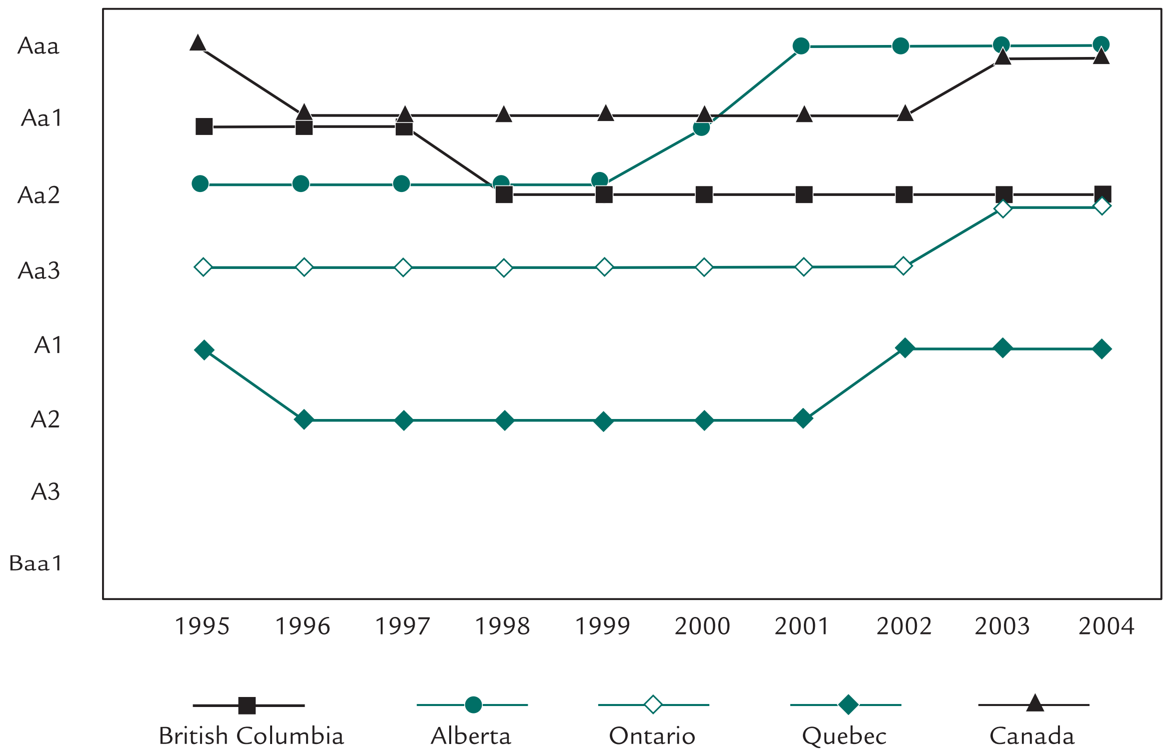
British Columbia ranks second among all jurisdictions with respect to the net liabilities to GDP indicator, behind Alberta, and has maintained this position for all years since fiscal 1997. British Columbia's ratio of net liabilities to GDP has remained fairly constant since 1997, while many other provinces have shown improvement over the last several years.

Exhibit 28 compares British Columbia's credit rating by Moody's Investors Service to the rating for Alberta, Ontario, Quebec and Canada for the 10 years ending March 31, 2004. Appendix D provides the credit ratings for these jurisdictions and the six remaining provinces.

Exhibit 28

Credit Rating, for Canada and four of the Provinces, 1995 to 2004

Credit ratings as at March 31 of each year



Source: Moody's Investors Service

Recommendation:

We recommend that the government improve on its use of indicators of financial condition, using those identified by the Canadian Institute of Chartered Accountants and other important financial and economic measures, in its Public Accounts and other public documents, in order to better inform the legislators and citizens of British Columbia about the state of the government's finances.

Response from the Ministry of Finance

Response from the Ministry of Finance

We appreciate the opportunity to respond to the Auditor General's comments and acknowledgement of the government's continuing progress in adopting best practices in financial reporting.

The Province of British Columbia continues to be a leader in Summary budgeting and reporting where the operations of Crown corporations and agencies are fully reflected in our Budget documents and in our Public Accounts. The Budget documents are our financial plan, and the Overview and Provincial Debt Summary within the Public Accounts reports the actual results against that plan and includes additional graphs and commentary. The Province, via the Internet, also provides public access to the Financial and Economic Review with its expanded budgetary variance analysis, economic commentary and historical reference information. As stated last year, much of the data the Auditor General included in his suggested framework is provided in those documents.

The Province currently prepares its statements in accordance with Generally Accepted Accounting Principles (GAAP) except for inclusion of the Schools, Universities, Colleges and Health Authority (SUCH) sectors and reports this information as supplemental information. For the 2004/05 fiscal year, the government changed its budget and quarterly report presentation to fully conform to GAAP, and to create greater consistency between the Budget and Public Accounts by including the SUCH sector in its budget and reporting entity. This format is consistent with the recommendation in last year's Auditor General report on this issue. However, while revenues and expenses of taxpayer-supported organizations are detailed, revenues and expenses of government "Enterprises" are netted, since government wishes to be consistent with GAAP. Under GAAP, Government Business Enterprises, e.g. BC Hydro, must be accounted for on a modified equity basis where the financial statements show the Province's investment in these organizations on a net basis.

The Province also requires government, as well as individual ministry and Crown corporations and agencies, to prepare three-year service plans and reports that disclose goals and objectives and related performance measures to be released with the Budget and Public Accounts.

Therefore, the Province already provides a detailed accountability loop from planning to reporting. In terms of the timeliness of financial reporting, British Columbia was amongst the very first in the country *in the release of its audited Financial Statements. This is the third year in a row for June release of the Public Accounts. Although we are in the relatively early stages of performance reporting, and while there is room for improvement, it is clear the government has dramatically improved its financial and accountability information. The Province's reporting is extensive particularly when compared to other provinces.*

Also, as stated last year, the Province of British Columbia leads other jurisdictions by legislating that the Province must produce its budget and financial reports in full compliance with GAAP for senior governments. Compliance is required beginning with the 2004/05 budget. Achieving this goal continues to be clearly one of government's top priorities. Significant policy, technical and administrative issues still need to be resolved in making this very major change to the Government Reporting Entity (GRE). The Public Accounts for 2004/05 are to be released by June 30, 2005 and will be based on the new expanded reporting entity. BC is alone in including all SUCH sectors in its Public Accounts. It is expected that the current reservation on the financial statements will be removed with the June 2005 Public Accounts.

We generally agree with the disclosure principles advocated by the Auditor General. However, the presentation of the Auditor General is but one possible approach and we do not agree with the recommended disclosure for Government Business Enterprises. The Public Sector Accounting Board (PSAB) and GAAP currently recommend modified equity accounting for Government Business Enterprises. The Auditor General format, which advocates breaking out the financial statements into "General Programs" and "Enterprises," is not the format currently illustrated in the PSAB Handbook. A new task force is being struck by PSAB to address segment reporting, but it is too early to make any assumptions on how our Public Accounts disclosure will, if at all, be impacted as a result of the determinations of that task force.

The Auditor General has recommended additional disclosure to accompany the Public Accounts beyond GAAP requirements and beyond our current reporting, which currently exceeds GAAP requirements. We also agree that it is important for governments to provide explanatory context for their financial reports; however, when it comes to explanatory commentary provided by governments with their audited statements, there is no agreed upon guidance currently provided by the accounting profession. Much of the expanded information as proposed by the Auditor

General is based on the recommendations included in the Statement of Recommended Practices on Financial Statement Discussion and Analysis issued by the PSAB in June 2004. While this is suggested practice by PSAB, it is not yet GAAP and may significantly change in the future. Therefore, the Province is not required to follow the practices in meeting its legislated GAAP commitment. Additionally, no information is currently available whether or not there is widespread acceptance of these recommendations by other jurisdictions. Because of these uncertainties, the Province has not fully adopted these suggested practices.

There is no general use of all the Canadian Institute of Chartered Accountants' (CICA) Indicators of Government Financial Condition recommended by the Auditor General, in part, because of concerns over their reliability as measures. Some of these, and other indicators, are being used by various jurisdictions, including British Columbia.

Since British Columbia is the first major Canadian jurisdiction to legislate GAAP and there is such a diversity of reporting across the country, comparing information across jurisdictions for anything more than indicative purposes would be misleading. Other provinces do not have the same organizations nor are they currently including the same entities in their GRE. Therefore, meaningful comparisons are difficult. Until greater consistency is achieved across Canada, at least in terms of the application of accounting guidance, any comparisons should be made cautiously.

As the government strives for continuous improvement of reporting, it must also take into account the value of any new information to the report users, its cost, its additional impacts on entities included in the GRE, its impact on timeliness of reporting and the avoidance of duplication across reports. As stated earlier, the Province already does a significant amount of explanatory reporting through a variety of documents. The government, on an on-going basis, reviews and modifies reporting requirements to adapt to best practices and enhance meaningful analysis. There is always room for improvement; however, keeping up with evolving GAAP/PSAB guidance is challenging in its own right—raising the bar will have to be done cautiously, in consultation with the Office of the Auditor General with general agreement across jurisdictions and can only be accomplished with the support of all those entities that are included in the reporting entity. We also require agreement on the reporting standard by the accounting profession.

Some of the difficulties the Province faces if it were required to include the draft disclosure in the Public Accounts, include but are not limited to:

- *Duplication of existing reporting.*
- *The full consolidation of Government Business Enterprises distorts government revenues and expenses and creates volatility which is, for example, based on commercial transactions, such as the purchase and sale of power as opposed to changes in government revenue or expense trends.*
- *Acquiring some of the additional recommended information would require extra resourcing and put even further stress on Crowns and SUCH sectors that currently have no GAAP requirement to produce the proposed information.*
- *Some of multi year trend analysis information, particularly that associated with the SUCH sector, is not currently collected. This historical information may not be available even if cost was not an object. Lack of availability of historical information would make some of the trend analysis difficult, if not impossible. Some information upon which the Auditor General has based his trend analysis was draft information based on unaudited estimates and therefore, may not be reliable for doing trend analysis. It is our intention to build future trend analysis into our reporting but the basis will be audited information.*
- *Different accounting policies impact reported amounts making it sometimes very difficult to follow numbers through the financial statements or to do meaningful comparatives over multiple years.*
- *Inclusion of the recommended disclosure and analysis will impact the timeliness of the release of the Public Accounts.*
- *Because of the Province's early release of its Public Accounts, current year comparative information is not available from other jurisdictions.*

Improvements will be made over time; however, in the immediate future we are concentrating our resources on meeting the legislated commitment of making the Budget documents, Estimates and Summary Financial Statements fully compliant with GAAP . We look forward to working with the Auditor General on this priority project following the introduction of full GAAP compliance and receipt of definitive guidance from the Public Sector Accounting Board.

Appendices

2003/04 Public Accounts Overview (unaudited)

Financial Statement Discussion and Analysis Report

Appendix B: Gross Domestic Product (GDP) per Capita

The ratio of GDP per capita for all provinces and Canada, for the fiscal years 1997 to 2004*

(Dollars)

	1997	1998	1999	2000	2001	2002	2003	2004
British Columbia	28,091	28,940	28,932	30,147	32,455	32,381	32,941	34,342
Alberta	35,504	37,776	36,959	39,648	47,827	49,451	48,175	54,100
Saskatchewan	28,513	28,589	28,829	30,323	33,437	33,580	34,731	36,963
Manitoba	25,125	26,218	27,216	27,967	29,765	30,664	32,072	32,741
Ontario	30,516	31,996	33,187	35,548	37,716	38,067	39,523	40,318
Quebec	24,960	25,952	26,797	28,787	30,611	31,444	32,988	33,961
Newfoundland and Labrador	18,627	19,088	20,506	22,859	26,256	27,195	31,898	34,644
New Brunswick	22,134	22,398	23,417	25,354	26,868	27,696	28,217	29,771
Nova Scotia	20,991	21,817	22,864	24,688	26,520	27,972	29,017	30,783
Prince Edward Island	20,801	20,496	21,759	23,228	24,445	25,358	27,358	28,138
Canada	28,278	29,437	30,249	32,313	35,080	35,724	36,923	38,533

*GDP data is for the calendar year ending in the above fiscal years. Population is as at July 1 of the fiscal year.

Source: Statistics Canada

Appendix C: Net Liabilities to Gross Domestic Product (GDP)

The ratio of net liabilities to GDP for all provinces and Canada, for the fiscal years 1997 to 2004*

(Percent)

	1997	1998	1999	2000	2001	2002	2003	2004
British Columbia	17.69	17.25	17.91	17.68	16.17	17.57	19.16	18.96
Alberta	8.82	5.58	4.54	1.77	-2.99	-3.34	-4.51	-6.18
Saskatchewan	32.14	30.71	29.93	27.37	24.40	25.93	26.84	25.28
Manitoba	29.31	28.36	27.86	30.40	27.54	27.80	27.70	n.a.
Ontario	32.11	31.32	30.36	32.64	30.06	29.17	27.74	28.08
Quebec	35.71	46.63	45.14	42.30	39.02	39.81	38.77	n.a.
Newfoundland and Labrador	69.42	69.04	70.25	66.37	60.86	62.92	58.05	n.a.
New Brunswick	32.66	34.04	33.53	35.75	33.69	31.79	31.72	n.a.
Nova Scotia	42.82	45.55	48.06	48.71	45.90	46.52	45.11	42.80
Prince Edward Island	35.91	36.40	33.34	31.97	31.20	31.15	31.11	n.a.
Canada	69.50	65.67	63.04	57.46	50.66	51.52	48.78	n.a.

n.a.—not available

*GDP data is for the calendar year ending in the above fiscal years.

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

Appendix D: Credit Ratings

Credit rating for all provinces and Canada, as at March 31 for the fiscal years 1995 to 2004

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
British Columbia	Aa1	Aa1	Aa1	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2
Alberta	Aa2	Aa2	Aa2	Aa2	Aa2	Aa1	Aaa	Aaa	Aaa	Aaa
Saskatchewan	A3	A3	A3	A3	A2	A2	A1	A1	Aa3	Aa3
Manitoba	A1	A1	A1	A1	Aa3	Aa3	Aa3	Aa3	Aa2	Aa2
Ontario	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa2	Aa2
Quebec	A1	A2	A2	A2	A2	A2	A2	A1	A1	A1
Nova Scotia	A3	A3	A3	A3	A3	A3	A3	A3	A3	A3
New Brunswick	A1	A1	A1	A1	A1	A1	A1	A1	A1	A1
Newfoundland and Labrador	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	A3	A3
Prince Edward Island	A3	A3	A3	A3	A3	A3	A3	A3	A2	A2
Canada	Aaa	Aa1	Aa1	Aa1	Aa1	Aa1	Aa1	Aa1	Aaa	Aaa

Source: Moody's Investors Service

Appendix E: Office of the Auditor General: 2004/05 Reports Issued to Date

Office of the Auditor General: 2004/05 Reports Issued to Date

Report 1

Follow-up of Performance Reports, April 2004

Report 2

In Sickness and in Health: Healthy Workplaces for British Columbia's Health Care Workers

Report 3

Preventing and Managing Diabetes in British Columbia

Report 4

Internal Audit in Health Authorities: A Status Report

Report 5

Salmon Forever: An Assessment of the Provincial Role in Sustaining Wild Salmon

Report 6

Leading the Way—Adopting Best Practices in Government Financial Reporting—2003/2004

Report 7

Monitoring the Government's Finances
Province of British Columbia
November 2004

This report and others are available on our website at http://www.bcauditor.com

Compiled and typeset by Graphic Designer, Debbie Lee Sawin, of the Office of the Auditor General of British Columbia
and published by the Queen's Printer for British Columbia©
Victoria 2004