REPORT
OF THE
BRITISH COLUMBIA
FISCAL REVIEW PANEL

BRITISH COLUMBIA FISCAL FORECAST AND ISSUES
2001/02 TO 2003/04

July 23, 2001
July 23, 2001

Honourable Gordon Campbell
Premier
Parliament Buildings
Victoria, British Columbia

Dear Mr. Premier:

It is with pleasure that I submit the Report of the British Columbia Fiscal Review Panel. In accordance with your instructions when the Panel was constituted, this report is being released to the public at the same time.

On May 25, 2001 you appointed the Fiscal Review Panel, made up of a cross-section of representatives from the business community to conduct an independent review of the province’s fiscal situation and report to the public by July 31, 2001. The purpose of the review was to establish a credible financial baseline against which fiscal results can be measured.

This is not an audit. We conducted the review by seeking information from the professional public service and the public. We make no representation about the completeness or accuracy of the information. We also note that at the heart of the analysis is a forecast of the future fiscal situation for British Columbia should the status quo be maintained.

It is also important to state that we found the current accounting policies, financial reporting and capital planning processes of the province substantially sound. Obviously, our confidence in those areas assisted with the preparation of this report.

We were impressed with the quality of information provided by the public service and submissions from interested non-government organizations and members of the public. The Panel gratefully acknowledges the effort of all participants.

Sincerely,

Gordon R. Barefoot, CA, Chair

Panel Members
Gordon R. Barefoot, CA (Chair), Linda Coady, John Cowperthwaite, CA, Tim Duholke, CA, Hugh Gordon, FCA, Mary MacGregor, Stephen Thomson
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EXECUTIVE SUMMARY

OUR CONCLUSIONS

Based on our mandate to conduct an independent review of the province’s fiscal situation and report to the public, we have concluded:

1. Revenues in the 2000/01 and 2001/02 fiscal years include windfall gains due to high and volatile energy prices that are unlikely to be maintained over the next few years.

2. The budget provided for a 7.4% increase in expenses primarily due to increases in the social policy areas (health, education, community social services and protection of people and property). Status quo spending is forecast to grow by over 6% annually through 2003/04 as these cost pressures continue unabated.

3. On a status quo basis there would be a small deficit of $24 million for 2001/02 before any policy changes such as the announced personal income tax cut, compared to the $1.1 billion surplus forecast in the March 2001 budget.

4. Without the legitimate but one-time gain of $1.4 billion due to the change of public sector pension plans to a joint trusteeship basis, our small projected deficit in 2001/02 would be a $1.4 billion deficit.

5. Our status quo forecast for the following two years is for deficits of $3.0 and $3.8 billion before the tax cut.

6. These projected deficits indicate a structural fiscal imbalance that represents a serious threat to the financial health of the province. While we are not in an immediate financial crisis, government is operating in a fundamentally unsustainable manner.

Chart A1 – Forecast Deficit/Surplus

Expected multi-billion dollar deficits represent a serious threat to the financial health of the province.
However

7. Unlike some other jurisdictions, British Columbia’s relatively low debt gives it the capacity to run deficits in the short run while a “made-in-BC” solution replaces incremental budgeting with a base-line review of programs and services.

8. While tax increases are clearly not an option, there may be other untapped revenue sources. Significant public debate about the tradeoffs and policy changes may be necessary to realize on this revenue.

9. Fundamental change is required but cuts in key services should not be the solution. Arbitrary spending cuts can be avoided by focusing on services that yield results, on improving efficiency of service delivery and on economic performance. Services that do not provide tangible and marked benefits are candidates to be cut or replaced. Spending reductions will ultimately be required, generating considerable debate and presenting difficult choices.

10. In general we believe that accounting policies and financial reporting are substantially sound, although we note that financial credibility could be improved by implementing outstanding recommendations of the Budget Process Review Panel (Enns Report).

We recommend:

- a comprehensive review of public sector spending, revenue sources and regulatory activities, to identify the needed fundamental change;

- increased emphasis on measuring results and managing for results based on the objectives arising from the review, to enhance accountability;

- implementation of outstanding recommendations from the Enns Report and creation of an accounting advisory panel, to further improve financial credibility.
**Forecast Review**

The Panel was asked to prepare a status quo fiscal forecast, before the effects of policy changes, such as the tax cut. The results are summarized in Table A1.

Our fiscal forecast is based on a status quo economic forecast that also does not include the impacts of already announced policy changes. Because of its significance, we show in Table A1 the direct impact of the announced tax cut. We understand that the effects of the tax cut and other policy changes on the economy will be projected by the Minister of Finance when he releases a economic and fiscal update on July 30, 2001.

**Table A1 – Summary Accounts Operating Results**

<table>
<thead>
<tr>
<th></th>
<th>Budget 2001/02 $ billions</th>
<th>2002/03 $ billions</th>
<th>2003/04 $ billions</th>
<th>Panel Status Quo 2001/02 $ billions</th>
<th>2002/03 $ billions</th>
<th>2003/04 $ billions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Summary Accounts Balance Before Forecast Allowance &amp; Pension Adjustment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>(0.7)</td>
<td>(1.9)</td>
<td>(2.5)</td>
<td></td>
</tr>
<tr>
<td><strong>Forecast Allowance</strong></td>
<td>(0.3)</td>
<td>Nil</td>
<td>Nil</td>
<td>(0.7)</td>
<td>(1.1)</td>
<td>(1.3)</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>(0.3)</td>
<td>Nil</td>
<td>Nil</td>
<td>(1.4)</td>
<td>(3.0)</td>
<td>(3.8)</td>
</tr>
<tr>
<td><strong>Pension Adjustment</strong></td>
<td>1.4</td>
<td>Nil</td>
<td>Nil</td>
<td>1.4</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td><strong>Summary Accounts Surplus (Deficit)</strong></td>
<td>1.1</td>
<td>Nil</td>
<td>Nil</td>
<td>(3.0)</td>
<td>(3.8)</td>
<td></td>
</tr>
<tr>
<td><em>less:</em> Direct Impact of Tax Cut</td>
<td></td>
<td></td>
<td></td>
<td>(1.2)</td>
<td>(1.5)</td>
<td>(1.5)</td>
</tr>
<tr>
<td><strong>Summary Accounts Surplus (Deficit) After Tax Cut</strong></td>
<td></td>
<td></td>
<td></td>
<td>(1.2)</td>
<td>(4.5)</td>
<td>(5.3)</td>
</tr>
</tbody>
</table>

1 Adjustment to the pension liability resulting from the change of public sector pension plans to a joint trusteeship basis.

2 The Ministry of Finance has provided the Panel with a revised estimate of the direct impact of the tax cut in 2001/02.

Our forecast indicates that the framework of government revenues and expenses is structurally unbalanced. It is important that the government take action quickly to address this issue. It is beyond the Panel’s mandate to suggest specific measures to resolve the issue. Nevertheless, the Panel believes that fundamental changes are needed to ensure British Columbia’s future financial health.

Our forecast is intended to be reasonably conservative. We have included a forecast allowance as a means of managing risk. This allowance is greater than the amount used in the last provincial budget. It is consistent with identified potential spending increases that the Panel reviewed as we met with the various ministries, agencies and Crown corporations and with factors used to introduce conservatism in other jurisdictions, such as Alberta, Ontario and the federal government. Our forecast allowance also reflects the volatile
nature of revenues, particularly resource revenues and is lower in the current year because the first quarter has already passed.

The pension gain has a legitimate but non-recurring positive impact on the accounts of the province in the 2001/02 fiscal year and as a result masks the emerging structural fiscal imbalance.

**Revenue**

The deficit/surplus is comprised of four elements – revenue less expenses plus the net income of Crown agencies less the forecast allowance. For the purposes of this executive summary, revenue and Crown agency net income are considered together.

Revenues in British Columbia are volatile, largely due to the influence of the cyclical natural resource sector in the economy and the importance of natural resource revenues in the province’s revenue base.

There was a material increase in revenues in 2000/01, mostly due to increased energy revenues as a result of high energy prices (see Chart A2). The budget assumed that electricity and natural gas prices would decline only slightly by the end of 2003/04. We feel this was optimistic, especially in the out-years and have reduced our forecast accordingly.

Revenues are also sensitive to economic performance. Taxation and other revenue sources are driven by economic factors such as personal income, retail sales and population growth. The economic outlook for British Columbia and North America has deteriorated since the March 2001 budget.

British Columbia’s economic performance has lagged behind the other provinces for much of the past decade. British Columbia’s competitiveness with other jurisdictions and the business and investment climate have become significant public issues.

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July 23, 2001
This means that options to address the fiscal problem by increasing taxes are limited. It also means that improving competitiveness and the investment climate can improve economic performance and revenues. In general terms a 1% increase in economic growth generates $200 to $300 million in revenue if all the parts of the economy grow by the same amount.

In addition to taxation, the regulatory burden and the complexity of land use planning and approval processes are factors in the investment climate.

Finally, we believe that the uncertainty related to Aboriginal land claims has a negative impact on economic growth and activity.

There may be some revenue upside in the future that cannot be quantified at this time. Resolution of the softwood lumber dispute may provide some increased revenue sources and full implementation of existing gaming policies may add revenue. However, it is important to note that in many instances, options for expanding the province’s fiscal capacity require policy changes.

Expense

The Big 6 ministries account for 86% of 2001/02 expenses and almost all of the growth in expenses (see Chart A3).

Much of the expense of these ministries is in the form of contributions to agencies which directly deliver service such as health authorities, school districts, post-secondary institutions, doctors and non-profit community social services agencies. Chart A4, which is based on the entire summary entity rather than just the CRF, shows that sector payments amount to 53% of total expense, comprised of Sector Compensation Costs (44%) and Other Sector Costs (9%).

Salaries, benefits and other compensation costs comprised about 54% of total expense, of which 10% is in ministries (Direct Salaries) and 44% is outside of the direct government (Sector Compensation Costs).

Combining Direct Salaries in ministries (10%) and Other Direct Costs (11%) provides an indicator of the total proportion of overhead and direct
service delivery costs (21%). Obtaining greater efficiencies in these areas could resolve only a small part of the deficit problem.

Historically in Canada there has been a perception that there is a direct relationship between the amount of government spending and the level and quality of services provided by government (i.e. the higher the level of spending the better the service). More recently this view is being challenged by growing public concern in most provinces that, notwithstanding ongoing increases in government spending, government services in general are deteriorating, particularly in health and education. For that reason, we believe that changes must focus on measurable results.

**Managing for Results**

**COMPREHENSIVE REVIEW**

Our review suggests that fundamental change is needed to address the current deficit problem in British Columbia. We have not been asked to recommend what those changes may be and we are not doing so. Nevertheless, we clearly understand and acknowledge that reducing government spending by cutting costs is an essential component of the type of fundamental change required. This issue was raised in many of the submissions we received from business and labour organizations. Based on recent experience in other Canadian provinces, we are concerned that cost cutting in government often comes at the expense of those groups in our society that can least afford it or by lowering standards designed to protect the environment and public health and safety.

We do not believe this should be or has to be the case in British Columbia. To the contrary, we believe that BC has an opportunity to address the deficit problem in a manner that avoids mistakes made elsewhere. We offer the observation that for the past several years, government budgeting in BC has been incremental in nature, focusing on increases and decreases to the base budget, which has not been examined in detail for several years. We believe
arbitrary and disruptive reductions in key services can be avoided if government undertakes a comprehensive review of all of its activities designed to focus on services that yield results as well as improving efficiency of service delivery and overall economic performance.

We recommend that changes needed to address the fiscal deficit not be implemented through across-the-board spending cuts but rather be identified through a comprehensive review of all government programs and activities including:

- a program objectives review,
- a base budget review,
- a regulatory review,
- consideration of revenue sources, and
- a review of Crown agencies.

In all cases the review would be based on asking what a program’s objectives are and what they should be. The review should examine the clarity of mandates and expectations, reporting relationships and the roles and responsibilities throughout the public sector. The review should analyze options for how best to achieve the appropriate objectives.

We note with encouragement that the government has already started to move in this direction and has publicly expressed a willingness to implement the outcome of its review in a manner that will ensure transparency and build the commitment of all interested parties. We believe that such an approach will create the capacity necessary to achieve responsible growth of the province’s economy.

While the current situation presents government with a significant challenge, with timely action it is manageable. Other provinces, such as Saskatchewan in the mid-1990’s, were only able to make changes when financial markets signaled that the situation was dire, effectively forcing the province to make deep spending cuts. British Columbia has a window of opportunity during which it has the flexibility to meet the challenge with targeted fundamental changes focused on objectives and results rather than spending cuts based on arbitrary cost-reduction goals. Difficult choices will have to be made.

ACCOUNTABILITY FOR RESULTS

A comprehensive review of this nature will also enhance efforts to increase accountability by measuring and reporting results. As a result of the recommendations in the Enns Report, the government has taken initial steps
to become more accountable for results. Implementation of this type of management system takes time, resources and strong support and leadership. Progress to date is recognized and commended. However, implementation has been slow and seems to lack sufficient priority as government still largely focuses on inputs (amounts spent) not outcomes (the results).

We recommend that the emphasis on accountability for results in government be renewed, based on the strategic priorities and objectives that will emerge from a comprehensive review of government.

Capital

Over the past several years, partly as a response to some high-profile failures (such as the fast ferries), management of taxpayer-supported capital expenditure has improved considerably. We found that the current capital plan, the capital planning process and the requirements for specific capital projects are solid.

Concerns have been raised about whether ongoing maintenance of existing assets has been inadequate, affecting the utility of buildings and other capital. We received some evidence of such “deferred maintenance” in post-secondary institutions and healthcare buildings and equipment as well as secondary roads. Apparently, this is not currently an issue in other sectors.

We believe government should consider ways to ensure that maintenance is not deferred, perhaps by ensuring that the usefulness of the capital stock is one of the results upon which performance is judged.

Future pressures for increased capital spending include:

- transportation, particularly rapid transit in the Lower Mainland;
- the capital costs that would be associated with a successful Vancouver/Whistler bid for the 2010 Winter Olympics; and
- capital needs in the health and advanced education sectors.
Debt

As explained in the “What is a Deficit or Surplus?” section of the report, British Columbia uses accrual accounting. As a result, the province’s taxpayer-supported debt arises from two sources – debt used to finance capital assets and debt used to finance operating deficits. In both cases, the use of debt financing by government effectively transfers costs from the present (when cash is spent) to the future (when debt is repaid). This is often referred to as an “intergenerational transfer.”

To the extent that debt is used to finance government’s current operations, the result is that today’s costs are passed forward to the next generation. However, to the extent that debt is used to finance schools, hospitals or other capital assets that will be used by the next generation, debt matches costs with the benefits or services provided over time.

What is the right level of debt? Currently British Columbia’s taxpayer-supported debt as a proportion of GDP and on a per capita basis is relatively low, second to Alberta. Another factor to consider is how the financial markets rate the debt of a province. In general, the proportion of debt and the future prospects of the province are factors in determining the government’s credit rating and the rate of interest that the province will have to pay to borrow money.

Unless the deficit problem is addressed, there is a danger that the amount of debt will get out of hand. As deficits continue, mounting interest costs make future deficits even harder to control. However, we believe that deficits in the short run and some associated increase in debt will be necessary until the proper restructuring of government can take place.
Financial reporting is fundamentally sound. We are recommending some further improvements.

Credibility of Financial Reporting

British Columbia is a Canadian leader in public sector financial reporting. We found that the province’s accounting policies and practices provide a high overall level of financial disclosure and accountability. In part, this is due to the Enns Report and the fall-out from the 1996 budget but other policies, such as the move to accrual accounting were implemented independently.

We recommend implementation of the Enns Report recommendations that:

- the SUCH sector (schools, universities, colleges and health authorities) be consolidated in the Summary Accounts in accordance with Generally Accepted Accounting Principles; and
- the budget fully consolidate taxpayer-supported Crown agencies.

The Panel acknowledges that the impact on the deficit/surplus of including the SUCH sector in the reporting entity is small and that there are challenges in terms of gathering information that may require some time to implement. However, on balance, we believe that this recommendation will improve financial disclosure and accountability.

Consolidation of taxpayer-supported Crown agencies in the budget presentation of the Summary Accounts operating results will provide better comparability between the budget and Public Accounts (which are already presented on a consolidated basis) but will not affect the deficit/surplus forecast. This change will ensure that the budget commentary focuses on Summary Accounts revenue and expense, which are better measures of the size of government than the measures currently focused upon by the budget, CRF revenue and expense.

We recommend that government consider establishing a public sector accounting advisory committee of respected members of the accounting profession and business community to help ensure that British Columbia remains a Canadian leader in sound financial disclosure.
## GLOSSARY OF TERMS

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accountability</td>
<td>The responsibility of a person acting on behalf of another person to report on what is planned to be done and on what the results were. For example, the government acts on behalf of the people, to whom it is accountable.</td>
</tr>
<tr>
<td>Asset</td>
<td>An asset is a thing that has value over time. Financial assets are things such as loans and ownership of shares. Capital assets are things like buildings, equipment and computer software which are used over time to provide services.</td>
</tr>
<tr>
<td>Budget</td>
<td>The fiscal plan of the provincial government, setting out fiscal forecasts and targets for the coming year together with the assumptions and policy changes upon which the forecasts and targets are based.</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>The purchase or construction of capital assets that will be used over time to support government operations, such as buildings, computer systems, roads, ferries, buses, etc.</td>
</tr>
<tr>
<td>Capital Stock</td>
<td>The set of capital assets available for use to support public sector activity at a given time.</td>
</tr>
<tr>
<td>Contingent Liabilities</td>
<td>Amounts that the government may owe to others, where the existence or amount of the liability depends on future events, such as court cases.</td>
</tr>
<tr>
<td>Cost or Revenue Driver</td>
<td>Most government programs and revenue sources respond primarily to changes in one or two factors, which are commonly referred to as “drivers.” For example, provincial sales tax revenues primarily depend on the level of retail sales and, to a lesser extent, the level of spending by business on machinery and equipment. Enrolment is one driver of K-12 education costs. Fiscal forecasts depend on assumptions made about revenue and cost drivers.</td>
</tr>
<tr>
<td>Debt</td>
<td>The outstanding amount of money that the provincial government has borrowed from others to finance its operations. The main reasons that government borrows are to finance deficits and to finance capital expenditures. In British Columbia, debt is classified as taxpayer-supported and self-supported debt.</td>
</tr>
<tr>
<td>Deficit or Surplus</td>
<td>The difference between expense and revenue for a given year. If expense exceeds revenue in the year, there is a deficit and if revenue exceeds expense, there is a surplus.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
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<tr>
<td>Enns Report</td>
<td>Credibility, Transparency and Accountability – Improving the B.C. Budget Process, the final report of the Budget Process Review Panel, an independent panel appointed to recommend improvements to the budgeting and financial management of the Province of British Columbia, chaired by Douglas J. Enns, FCA, which reported on September 27, 1999.</td>
</tr>
<tr>
<td>Estimates or “Blue Book”</td>
<td>The document tabled in the legislature after the reading of the budget speech detailing expected expenses and expenditures (such as capital expenditures) that the Legislature is being asked to approve.</td>
</tr>
<tr>
<td>Expense</td>
<td>In accrual accounting, expense denotes an amount paid, an obligation to make a payment or the recognition of a cost associated with the use of a capital asset (i.e. amortization) that relates to the particular period.</td>
</tr>
<tr>
<td>Forecast</td>
<td>In the context of the Budget, a forecast is an estimate based on a set of assumptions of a result that depends primarily on changes in economic or other conditions. For example, forecasts are used in establishing budget estimates for items such as tax revenues.</td>
</tr>
<tr>
<td>Gross Domestic Product (GDP)</td>
<td>An economic indicator that measures the size of the provincial economy. The focus is often on the rate of growth of GDP rather than its absolute size.</td>
</tr>
<tr>
<td>Nominal &amp; Real GDP</td>
<td>Real GDP refers to GDP adjusted to remove the effects of inflation and is sometimes referred to as “constant dollar” GDP since it converts GDP to the equivalent value in the purchasing power (dollars) of a given year. Nominal GDP is unadjusted GDP, sometimes referred to as “current dollar” GDP.</td>
</tr>
<tr>
<td>Investments</td>
<td>Financial assets held by the government to generate income, such as shares of corporations, bonds and loans made to individuals, corporations or other governments.</td>
</tr>
<tr>
<td>Out-years</td>
<td>In the context of a multi-year fiscal forecast, the years following the budget year. In the case of the 2001/02 budget and this report, fiscal forecasts have been prepared for the budget years and for the two following out-years (2002/03 and 2003/04).</td>
</tr>
<tr>
<td>Per Capita</td>
<td>Means per person on average. In order to make indicators such as revenue, expense or debt comparable across provinces or other jurisdictions that differ in size, the indicator can be divided by the population and presented on a “per capita” basis.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
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<tr>
<td>Public Sector Accounting Board (PSAB)</td>
<td>A committee created by the Canadian Institute of Chartered Accountants to recommend accounting standards for the Canadian public sector, including federal, provincial and local governments. The recommended standards are also sometimes loosely referred to as “PSAB.”</td>
</tr>
<tr>
<td>Reporting Entity</td>
<td>The set of organizations whose financial results are consolidated in the provincial government’s summary financial statements. The reporting entity may include a wide variety of types of organizations such as government ministries, Crown corporations, boards, commissions and other government agencies, school districts, health authorities and post-secondary institutions, depending on government accounting policy.</td>
</tr>
<tr>
<td>Self-Supported Commercial Debt</td>
<td>Debt of commercial Crown corporations (such as BC Hydro) that is supported by their commercial activities is self-supported commercial debt.</td>
</tr>
<tr>
<td>Structural</td>
<td>Structural is used to refer to a circumstance arising from systemic factors that are expected to be ongoing. For example, a structural deficit or surplus refers to a systemic fiscal imbalance that excludes one-time and extraordinary events, such as the one-time gain arising from the change in public sector pension plans to joint trusteeship or windfall revenues arising from spikes in energy prices. Another example is the term “structural change” which means a fundamental systemic change in the way services are delivered, the services that are delivered or the policy framework for raising revenue.</td>
</tr>
<tr>
<td>Targets</td>
<td>In the context of the Budget, a target is an estimate based on a set of assumptions that depend upon both external factors and on management decisions. For example, targets are set for ministry expense.</td>
</tr>
<tr>
<td>Tax Cut</td>
<td>The reduction of provincial personal income taxes which was announced on June 6, 2001 and took effect July 1, 2001.</td>
</tr>
<tr>
<td>Taxpayer-Supported Debt</td>
<td>Debt of the provincial government that relies upon government for its repayment. Debt incurred to cover deficits and to support capital expenditure of government and taxpayer-supported Crown agencies (but not commercial Crown agencies) is taxpayer-supported debt.</td>
</tr>
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</table>
BACKGROUND

Purpose

On May 25, 2001 Premier Gordon Campbell announced the formation of the Fiscal Review Panel to review the province’s fiscal situation. As the Premier indicated in making his announcement,

“It’s essential that all British Columbians have a clear, complete and accurate understanding of the province’s finances, so they can have confidence in the province’s fiscal statements – as a baseline for accountability now and in the future. The Fiscal Review Panel is an important first step toward building that public confidence, and providing a framework for our government’s future budget and public policy decisions.”

According to the Panel’s Terms of Reference (reproduced in Appendix A), the purpose of this report is to review the fiscal situation as it stood at May 25, 2001, to provide a basis for the new government to develop policy and budgets. The Panel was not asked to provide government with advice about the specific policy decisions it should consider and has not done so. The Panel has made limited recommendations directly related to financial disclosure, management and accountability.

The Panel was chaired by Mr. Gordon R. Barefoot CA, Senior Vice President, Planning and Development of BC Gas Inc. and was composed of seven respected professionals who bring a range of business, public sector and accounting expertise. Appendix B provides biographical information for the members of the Panel.

Approach

The Panel has not conducted an audit. In the short time available, the Panel gained only a general overview of the fiscal situation. No audit work was carried out and the Panel has relied upon the information presented to it without independent verification. The Panel is not expressing an opinion about the completeness or accuracy of the information received. This report is not intended to, and should not, be relied on as advice about investment decisions by the province or others.

As set out in the Terms of Reference, the Panel’s approach has been to gather information primarily by meeting over the course of several days of scheduled presentations with senior officials in the Ministry of Finance, various other ministries and Crown corporations. Twenty-four ministries and government agencies made presentations to the Panel or provided written information (see Appendix C). The Panel also asked the Ministry of Finance, the Economic Forecast Council and several ministries and agencies to provide additional information or analysis. The
Panel critically reviewed the information received and considered all of the information provided in reaching its conclusions.

The Panel wishes to acknowledge the efforts of those who provided the Panel with information and to thank those involved for the professional and timely responses to the Panel's requests. The Panel was impressed by the abilities of the staff and the quality of the information provided.

In addition, the Panel sought input from the public and received 26 submissions. A list of submissions received and highlights of some of the views expressed in the submissions are included as Appendix C. The views expressed in the public submissions were valuable in assisting the Panel to undertake its review and the Panel is grateful to all those who participated.

The submissions also made many specific policy suggestions that are beyond the scope of the Panel's Terms of Reference. All policy suggestions have been forwarded to the Premier for consideration.

**What is a Deficit or Surplus?**

The purpose of this section is to explain in plain language how government accounting works by examining the two things most people focus on – the deficit (or surplus) and the debt. What do they try to measure and how they are related?

First we will define the concepts, which we will then discuss in more detail. The annual “deficit or surplus” is the difference between the revenues and expenses of government attributable to a particular year. If revenues exceed expenses, the government has a surplus for that year. If expenses exceed revenues, government has a deficit for that year. In the private sector, the terms comparable to deficit or surplus are “loss or net income.”

The “debt” is the amount of money owed by the government to others. As will be discussed below, some debt may be from borrowing to finance past deficits. Debt is also used to finance capital expenditure. That is government may borrow money to build or buy schools, roads, hospitals, colleges and universities, computer systems, office and healthcare equipment and many other things that are used over time to help provide government services.

For the past two decades or so public sector accounting in Canada and throughout the world has been slowly moving to become more similar to private sector accounting. In most ways, British Columbia currently uses accounting practices that are consistent with those in the private sector.

A key principle in private sector accounting is the matching of expenses with the related revenues. Generally, expenses of a particular period are matched with the revenue earned in that period to provide an accurate calculation of the net income (or loss).
Public sector accounting follows similar matching rules. Operating costs of government are treated as expenses in the fiscal year they create a public benefit and not in the year in which they may be paid. Similarly, revenues are accounted for in the year when the taxpayer became obligated to make a payment to government rather than the year when the payment is actually made. In the private sector, operating revenues and costs are treated in much the same way.

One of the best examples of the impact of the matching issue is where an asset is acquired by the government that will provide a service for multiple years (such as building or a highway). The cost of such a ‘capital’ asset is expensed over the number of years that it is anticipated that the public will benefit from the asset. The amount of cost or expense recorded annually is termed “depreciation” or “amortization.” As a result, expense does not equal cash outlay.

This method of accounting is called “accrual accounting.” It shows government’s financial state at any particular point more clearly than a simpler accounting of just government’s cash receipts and cash payments. Without accrual accounting, results can be manipulated by adjusting the timing of cash payments. Accrual accounting forms the basis of “Generally Accepted Accounting Principles” (sometimes referred to as GAAP), the accounting standards set by associations representing professional accountants.

As explained above, the surplus or deficit is not a measure of government’s cash transactions. Thus, the surplus or deficit will not correspond directly to the change in the government’s debt position. To determine the change in government’s debt position the deficit or surplus must be adjusted to take into account changes in the holdings of cash and short term investments, amounts receivable and payable, and to add back items which are not current cash costs such as depreciation and amortization. This results in the amount of cash generated or consumed by current operations. From this is deducted the amount expended on asset acquisitions and investments, net of proceeds from the sale of assets and investments.

Much publicity is given to the Budget Speech and the projected deficit or surplus that the Minister of Finance tables each year in the Legislative Assembly. A budget deficit or budget surplus is a forecast and like all forecasts, it will be wrong to a lesser or greater extent. The actual deficit or surplus is not known until the government’s audited accounts are published in the summer following the end of the fiscal year on March 31. Although these actual accounts receive much less publicity than the budget forecast, it is these accounts which reflect what really happened.
What is a Status Quo Forecast?

Anyone who prepares a budget, whether for a family, a corporation or a government, must make forecasts of what he or she expects to happen in the future. The provincial government’s budget is basically a fiscal plan consisting of a spending plan and a revenue forecast, all of which is grounded in an economic forecast and a number of specified assumptions. In large part, the Panel’s mandate is to review the 2001/02 provincial budget and determine if it was a reasonable projection of the fiscal situation for the fiscal years 2001/02 to 2003/04.

There is a key element of forecasts that anyone who has ever predicted anything (and that is just about everyone) recognizes – forecasts are always wrong. Even for something as relatively simple as a family budget, over the course of a year there are unanticipated events that cause the actual results to differ from the expected results by some degree. In addition, forecasts are inherently subject to judgement. Even though forecasts and budgets are imperfect, they are a necessary part of planning. Government must plan so that it can provide services and be accountable to the public.

The Panel must address two questions about the budget forecasts:

- given the information available at the time, were the assumptions underlying the 2001/02 budget reasonable and did the budget reflect those assumptions; and
- since the budget, what has changed and how should the projected deficit/surplus be adjusted to reflect those changes.

By answering these questions, the Panel has developed a “status quo” fiscal forecast of its own, as required in our Terms of Reference. “Status quo” means without policy change. Of course, there will be policy changes. Some, such as the tax cut, cancellation of the photo radar program and the reorganization of ministries have already been announced and the Panel has received estimates of some of the fiscal implications of those changes. This report identifies the announced direct impacts of these changes but does not explore the economic implications of the changes or the indirect impact those economic effects will have on the fiscal situation. That is beyond the scope of this review. The Panel understands that the Minister of Finance will provide projections of the economic impacts as part of the economic and fiscal update on July 30, 2001.

It is important to recognize that some budgeted expenses can be controlled in the short run within existing programs, and other expenses are beyond government’s immediate control or can only be affected by major policy shifts. Using the family budget analogy, spending on recreation and entertainment can be quickly changed if the family chooses to do so. However the cost of rent or mortgage payments, which may change over the budget period because of rent increases or changes in interest rates, is relatively hard for the family to change unless the family moves or renegotiates its rent or mortgage arrangements.

The same issues apply to government. Given an established set of tax policies, the amounts collected from most revenue sources depend on factors such as economic
activity, inflation or population growth, which government does not directly control. Other budget elements, such as the cost of providing various government services, are subject to external factors such as population growth or other “cost drivers”, but also to a degree of management control even in the absence of major policy change. Where a budget forecast is subject to a significant amount of discretionary control, the forecast may also be called a “target” because in setting the amount, government can require that discretion be exercised to achieve the desired result. The question then becomes whether the target is achievable.

This discussion highlights the importance of disclosing the assumptions used in the forecasting process, in order to understand what government budget forecasts really mean. Recent budgets in British Columbia have provided substantial disclosure of the underlying assumptions pursuant to the Budget Transparency and Accountability Act (BTAA).

The BTAA also requires that the budget disclose the amount by which the budget forecast differs from the “most likely” forecast (i.e. the degree the budget forecast is optimistic or pessimistic). Many governments include implicit or explicit provisions to make their budget forecasts conservative (or pessimistic) because of concerns that credibility will be damaged if the final result is not better than or equal to the budget forecast.

Ministries, agencies and Crown corporations may also tend to produce conservative forecasts to ensure that their actual results will be better than the budget. Targets are one way that the Minister of Finance can adjust for this cascading conservatism. Setting targets that are challenging but feasible is a formidable task. Setting targets is a legitimate fiscal management tool when used appropriately.

STRUCTURE AND FINANCIAL TRENDS

What is in the Public Sector?

In order to review the fiscal situation of the provincial public sector, one first must determine what it includes.

Traditionally governments in Canada have provided most government services directly through ministries, with some exceptions such as school districts to provide K-12 education and separately managed colleges and universities, as well as a few Crown corporations. Historically, government financial reporting focused narrowly on money spent by the ministries and revenue sources dedicated to funding that expense. In most jurisdictions this was known as the “General Fund.”

Over time other funds and accounts were created, usually to dedicate revenue to a particular purpose. These funds were combined with the General Fund into the “Consolidated Revenue Fund” (CRF) in British Columbia to provide a more complete picture of the direct provincial government financial situation.
Increasingly in recent years, additional entities were created to provide government services outside the CRF, such as new Crown corporations and health authorities. The CRF did not include these entities. As a result it became clear that the CRF alone did not provide a complete picture of the provincial public sector financial situation.

In British Columbia, the provincial government currently does its financial planning and reporting on what is known as a “Summary Accounts” basis. The Summary Accounts consolidate financial results for the ministries and direct government, together with Crown corporations and other agencies that are controlled by the provincial government such as Forest Renewal BC, British Columbia Ferry Corporation, Industry Training and Apprenticeship Commission, British Columbia Hydro and Power Authority and British Columbia Liquor Distribution Branch.

Chart 1 shows the structure of the Summary Accounts. Appendix D lists the Crown corporations and agencies included in the Summary Accounts in the 2000/01 fiscal year.

The Summary Accounts do not include the full financial results for certain public sector activities—school districts, universities, colleges and health authorities—which are collectively called the SUCH sector. However, provincial government contributions to the operating budgets and capital costs of these entities are included in the Summary Accounts. The issue of whether or not the SUCH sector should be included in the Summary Accounts is discussed below under “Accounting Policy Issues”.

There are other entities, similar to public sector agencies, which are not included in the Summary Accounts because they are not owned or controlled by the government. These are primarily not-for-profit societies and agencies funded partially or fully under contract by the government. Many of these agencies are in the healthcare or community social services sectors. The Summary Accounts includes all government payments to these agencies but appropriately does not account for any external sources of revenue (such as donations) or any surplus or deficit they may have.
There is another subtle but important issue related to the Summary Accounts. Both the budget and the Public Accounts focus on the Summary Accounts deficit/surplus but they use a different format for the statements that show how the deficit/surplus has been calculated. In the Public Accounts, Summary Accounts revenue and expense are calculated by consolidating the results of taxpayer-supported Crown agencies with CRF revenue and expense and including self-supporting Crown agencies net income as a source of revenue. In contrast, the budget presents the CRF revenue and expense to calculate the CRF deficit/surplus, which is then adjusted by adding the net income of taxpayer-supported and self-supported Crown agencies to calculate the Summary Accounts deficit/surplus. Both methods result in the same value for the Summary Accounts deficit/surplus but the budget presentation does not provide Summary Accounts revenue and expense values. This issue is discussed further under “Accounting Policy.”

The practical problem this has presented for the Panel is that, while we were able to analyze Summary Accounts revenue and expense to provide historical context, we were unable to produce forecasts on that basis. Nevertheless, we have chosen to use Summary Accounts revenue and expense where possible because they are better indicators than CRF revenue and expense.

**Structure of Public Sector Revenue and Expense**

Chart 2 sets out an analysis of revenue and expense in the broad public sector, including the Summary Accounts and five other significant sectors within the broad public sector for the 1999/00 fiscal year, which is the most recent year for which such information is available. The audited results for 2000/01 have not yet been finalized and, while forecast Summary Accounts results are available, information is not yet available for many of the agencies outside of the government reporting entity.

As indicated by Chart 2 and Chart A4 in the Executive Summary, a good deal of social policy expense is in the form of contributions to agencies outside of the Summary Accounts. In 1999/00 these payments accounted for 53% of Summary Accounts expense and is believed to be of the same order of magnitude for 2000/01.

Chart 2 indicates that compensation represents a substantial proportion of expenses in all the sectors outside of the Summary Accounts. When the payments to sectors devoted to compensation are combined with direct wage costs within the Summary Accounts, compensation costs identified in this analysis represented 54% of Summary Accounts expense in 1999/00. Other studies have suggested compensation costs are up to two thirds of government costs.
Charts 3 and 4 examine the structure of Summary Accounts revenue and expense in 2000/01, based on the revised forecast provided in the March 2001 budget.

Taxation revenue is the largest source of revenue at 53%, followed by natural resource revenues at 15%. It should be noted that natural resource activities also affect total revenue through taxation revenues and the net income of commercial Crown agencies such as BC Hydro and Columbia Power, as well as through the natural resource royalties captured within natural resource revenue.

The analysis presented in Chart 4 looks at expense in terms of the type of service being provided.

Together health, education, social services and the protection of people and property accounted for 75% of Summary Accounts expense in 2000/01 and other services accounted for a further 16%. General government costs, not directed towards the delivery of services, accounted for only 2% of expense.
A key portion of the Panel’s findings depend on our understanding of the province’s fiscal situation. As context for the Panel’s review, we examined how the British Columbia fiscal situation has developed by reviewing various fiscal indicators.

Chart 5 shows the history of the deficit/surplus on both a Summary Accounts and CRF basis since 1988/1989. It shows that for much of the period, the results were similar. However, from fiscal 1995 to 1999, the Summary Accounts deficit was significantly higher as some government functions (and expenses) were moved to corporations and agencies outside the CRF. Examples include creation of the BC Transportation Financing Authority, Forest Renewal BC and the BC Assets and Lands Corporation.

Both revenue and expense increased substantially over the past five years, especially in the last year (see Chart 6). The result was roughly a balance early in the period, a deficit of about $1 billion in 1998/99 changing to a $1.3 billion surplus in 2000/01 according to the revised forecast provided with the March, 2001 budget.

Over the five year period, Summary Accounts revenue grew by 20.1%. Chart 7 shows that all of the revenue sources contributed significantly to revenue growth, but the largest
contribution (32% of the growth) has been from natural resource revenues. That growth (and to some extent the growth in taxation revenues and the revenues from Commercial Crowns) has been due to high energy prices increasing oil, gas and electricity based revenues.

During the period from 1996/97 to 2000/01 Summary Account expense grew by 13.1% net of decreases in interest costs. As Chart 7 shows, health and, to a lesser extent, education have been the major sources of expense growth.

Capital spending is spending on capital assets such as buildings and equipment. It is divided into self-supported capital spending by commercial Crown agencies and taxpayer-supported capital spending by ministries and taxpayer-supported Crown agencies.
Chart 8 summarizes capital spending over the past 10 years. In the mid-1990s the government imposed a capital freeze which produced a significant reduction. Except for the two years following the freeze, (1996/97 and 1997/98, taxpayer-supported capital spending was in the range of $1.7 to $2.0 billion throughout the period.

Government debt is money borrowed by government to finance capital spending or accumulated operating deficits. As Chart 9 demonstrates, net debt has increased significantly over the past decade, largely as a result of increases in taxpayer-supported debt. In spite of the decrease in capital spending in the mid-1990s, net debt has grown throughout the period.
In order to compare debt levels across provinces, the amount of debt must be adjusted for the size of the various provincial economies. One way to do that is to use net debt per capita.

Chart 10 compares net taxpayer-supported debt per capita for the provinces in 1991/1992 and 2000/01. The chart shows that while British Columbia's debt has increased significantly, as of March 31, 2001 it was second lowest on a per capita basis in Canada.

ECONOMIC FORECAST

The Forecast Process

For several decades, an economic forecast has been included in the budget documents. The economic forecast is an important part of the budget process because most revenue sources and many spending programs are driven by economic factors. For example, personal income tax depends on the level of personal income, which in turn is an element of Gross Domestic Product (GDP), a measure of overall economic activity in the province.

Since the fallout from the March 1996 pre-election budget, the economic forecast has taken on an even higher profile. As a result of government’s response to the Auditor General’s report and the Enns Report, the Budget Transparency and Accountability Act now requires more complete disclosure of the specific assumptions underlying all of the fiscal forecasts in the budget. These assumptions are generally about revenue and cost drivers, most of which come from the economic forecast, or about the effect of policy changes or management targets imposed by government.
Another measure introduced to increase accountability was the requirement that quarterly reports become more timely and that they include revised fiscal forecasts. That in turn requires that economic forecasts be updated throughout the year. Usually a pre-budget economic forecast is finalized early in the new year to prepare for a March budget. An update may be prepared in July for inclusion in the first quarterly report, released in September. Another update may be prepared in the fall for the second quarterly report and to support the consultation report required by statute as part of the budget process.

It is the responsibility of the Minister of Finance to decide on the specifics of the economic forecast and the resulting fiscal forecast. By disclosing the assumptions, it is possible for informed readers to form an opinion on the reasonableness of the forecasts. However, it is often difficult for the public to know whether or not the economic forecast is reasonable. For that reason, the Economic Forecast Council was formed to provide an independent benchmark against which the Ministry of Finance forecast can be compared. The Council typically meets annually to provide the Minister of Finance with advice and the Budget Transparency and Accountability Act requires the budget documents to include a report on the range of economic forecasts presented by the Council.

**The Current Forecast**

In order to review the fiscal situation for the current year and the two out-years, the Panel felt that it was important to first review the economic forecast upon which those fiscal forecasts must rest. The following discusses the Panel’s findings regarding the economic forecast.

As part of the fiscal review, the Ministry of Finance asked the Economic Forecast Council to update their economic forecasts and provided the Panel with the results. Chart 11 compares the Council members’ range of forecasts for 2001 real GDP growth as provided in January 2001 and May 2001. Chart 12 compares the 2002 real
GDP growth forecasts. The charts show that since the pre-budget forecast, the average forecast for 2001 has been reduced somewhat from 2.4% to 2.0%. For 2002 the average forecast remains unchanged at 2.9%, although several individual forecasters changed their forecast.

These forecasts were prepared before the cut to personal income taxes was announced. Most forecasters assumed no tax cut but some assumed a tax cut that would reduce taxes by about $500 million per year. In doing its work, the Panel is required by its Terms of Reference to review the fiscal situation from a status quo perspective, which means prior to any policy changes such as the tax cut. It is expected that the Minister of Finance will provide his own revised economic forecast when he tables the economic and fiscal update on July 30, 2001.

In general, the Panel believes that the economic forecast presented in the March budget was reasonable given the information available at the time. One exception is the issue related to energy prices discussed below. However, both Ministry of Finance staff and the Council have indicated that the economic outlook has changed since the budget forecast was prepared, with the outlook for the United States economy having deteriorated and energy prices having moderated.

As a result, the Panel asked the Ministry of Finance to prepare a revised economic forecast consistent with the revised outlook of the Council but on a status quo basis (before any policy changes). Table 1 presents the key elements of that forecast as compared to the budget economic forecast.

The Panel notes that, in some cases, the assumptions used in forecasting specific items in the budget differed from the economic forecast. For example, some agencies used a different interest rate forecast than was used in the economic forecast. The result was not material for the 2001/02 fiscal year. Because of the timing of preparing economic and fiscal forecasts, it is difficult to achieve perfect consistency. Nevertheless, the Panel believes that full consistency should be the
goal and, to the extent that cannot be achieved, the fact that an assumption disclosed in the budget differs from the economic forecast should be specifically highlighted.

Table 1 – Ministry of Finance Revised Economic Forecast

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>(indicator)</td>
<td>Actual</td>
<td>Budget</td>
<td>New Forecast</td>
<td>Budget</td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>5.8</td>
<td>4.0</td>
<td>3.3</td>
<td>3.4</td>
</tr>
<tr>
<td>Real GDP</td>
<td>3.8</td>
<td>2.4</td>
<td>1.8</td>
<td>2.9</td>
</tr>
<tr>
<td>Population</td>
<td>0.9</td>
<td>1.2</td>
<td>0.9</td>
<td>1.2</td>
</tr>
<tr>
<td>Labour Force</td>
<td>1.0</td>
<td>2.4</td>
<td>1.5</td>
<td>2.9</td>
</tr>
<tr>
<td>Employment</td>
<td>2.2</td>
<td>2.2</td>
<td>1.5</td>
<td>3.1</td>
</tr>
<tr>
<td>Unemployment Rate (%)</td>
<td>7.2</td>
<td>7.4</td>
<td>7.2</td>
<td>7.2</td>
</tr>
<tr>
<td>Retail Sales</td>
<td>6.3</td>
<td>3.5</td>
<td>3.6</td>
<td>3.8</td>
</tr>
<tr>
<td>Labour Income</td>
<td>6.4</td>
<td>3.7</td>
<td>3.3</td>
<td>4.1</td>
</tr>
<tr>
<td>Corporate Pre-tax Profit</td>
<td>3.9</td>
<td>4.0</td>
<td>1.5</td>
<td>–2.5</td>
</tr>
<tr>
<td>Housing Starts</td>
<td>–11.6</td>
<td>6.1</td>
<td>7.8</td>
<td>12.4</td>
</tr>
<tr>
<td>Consumer Price Index</td>
<td>1.9</td>
<td>1.7</td>
<td>2.0</td>
<td>1.6</td>
</tr>
<tr>
<td>Canadian Interest Rates</td>
<td>5.9</td>
<td>5.3</td>
<td>5.8</td>
<td>5.3</td>
</tr>
<tr>
<td>(10 year bond, %)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exchange Rate</td>
<td>67.3</td>
<td>66.4</td>
<td>65.5</td>
<td>68.0</td>
</tr>
</tbody>
</table>

In particular, the Panel notes that assumptions for key commodity prices such as natural gas and electricity prices used in the forecasts for 2002/03 and 2003/04 seem to have differed significantly from the economic forecast to make the fiscal forecasts more optimistic. While the assumptions around energy prices were disclosed in general terms, it was not clear in the disclosure that there was a difference between the economic forecast and the assumptions used. The impact is discussed below under “Revenue Forecasts.”
There is a serious structural imbalance that represents a threat to the financial health of the province.

DEFICIT/SURPLUS FORECAST

Forecast Summary

Table 2 is a summary of the Panel’s status quo forecast for the Summary Accounts deficit/surplus for the next three fiscal years. To develop this information, the Panel asked ministries and Crown agencies to prepare updated fiscal forecasts. In interpreting this forecast please refer to the commentary following the table.

Table 2 – Status Quo Forecast Summary

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Consolidated Revenue Fund</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>21,846</td>
<td>21,500</td>
<td>24,030</td>
<td>24,585</td>
<td>25,155</td>
<td>25,816</td>
<td>24,012</td>
<td>23,920</td>
</tr>
<tr>
<td>Expense</td>
<td>(22,200)</td>
<td>(22,078)</td>
<td>(22,615)</td>
<td>(24,295)</td>
<td>(25,045)</td>
<td>(25,783)</td>
<td>(24,457)</td>
<td>(25,755)</td>
</tr>
<tr>
<td>CRF Balance</td>
<td>(354)</td>
<td>(578)</td>
<td>1,415</td>
<td>290</td>
<td>110</td>
<td>33</td>
<td>(445)</td>
<td>(1,835)</td>
</tr>
<tr>
<td><strong>Crown Corporations and Agencies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxpayer-Supported</td>
<td>596</td>
<td>(306)</td>
<td>(266)</td>
<td>(313)</td>
<td>(218)</td>
<td>(171)</td>
<td>(311)</td>
<td>(213)</td>
</tr>
<tr>
<td>Self Supported</td>
<td>(190)</td>
<td>128</td>
<td>428</td>
<td>23</td>
<td>108</td>
<td>138</td>
<td>72</td>
<td>108</td>
</tr>
<tr>
<td>Total Net Income (Loss)</td>
<td>406</td>
<td>(178)</td>
<td>162</td>
<td>(290)</td>
<td>(110)</td>
<td>(33)</td>
<td>(239)</td>
<td>(105)</td>
</tr>
<tr>
<td><strong>Summary Accounts Surplus (Deficit)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>before Forecast Allowance and Pension Adjustment</td>
<td>52</td>
<td>(756)</td>
<td>1,577</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>(684)</td>
<td>(1,940)</td>
</tr>
<tr>
<td>Forecast Allowance</td>
<td>Nil</td>
<td>(300)</td>
<td>(150)</td>
<td>(300)</td>
<td>Nil</td>
<td>Nil</td>
<td>(730)</td>
<td>(1,100)</td>
</tr>
<tr>
<td>Pension Adjustment1</td>
<td>Nil</td>
<td>Nil</td>
<td>(112)</td>
<td>1,390</td>
<td>Nil</td>
<td>Nil</td>
<td>1,390</td>
<td>Nil</td>
</tr>
<tr>
<td><strong>Status Quo Summary Accounts Balance</strong></td>
<td>52</td>
<td>(1,056)</td>
<td>1,315</td>
<td>1,090</td>
<td>Nil</td>
<td>Nil</td>
<td>(24)</td>
<td>(3,040)</td>
</tr>
<tr>
<td>less: Direct Impact of Tax Cut2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Surplus (Deficit) After Tax Cut</td>
<td>52</td>
<td>(1,056)</td>
<td>1,315</td>
<td>1,090</td>
<td>Nil</td>
<td>Nil</td>
<td>(1,174)</td>
<td>(4,540)</td>
</tr>
</tbody>
</table>

1 Adjustment to the pension liability resulting from the change of public sector pension plans to a joint trusteeship basis.
2 The Ministry of Finance has provided the Panel with a revised estimate of the direct impact of the tax cut in 2001/02.

The Panel has developed its fiscal forecast based on the following:

- The Revised Forecast for fiscal 2000/01 presented for comparison purposes is the revised forecast that appeared in the March 2001 budget. The Comptroller General and the Auditor General are in the process of finalizing the audited 2000/01 Public Accounts and the actual final results will differ somewhat from the budget forecast. Since the Public Accounts will not be finalized until after this report is published, the budget forecast has been used as a reasonable basis for comparison;

- The Panel has used status quo revenue and expenditure forecasts prepared for the Panel by the Ministry of Finance as the basis for its forecast. Ministries and

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The Panel’s forecast for 2001/02 is worse than the budget due to a lower economic forecast, softening energy prices and some expected spending increases.

agencies making presentations and submissions to the Panel indicated that there are significant pressures and risks to the forecast that may not be managed within the status quo expense forecast. In part these risks have been offset by specifying a significant forecast allowance that is discussed below;

- The Panel has included the estimated direct cost of the personal income tax cut in its summary table for information purposes, although it is not part of the Panel's status quo forecast. Officials in the Ministry of Finance informed the Panel that there was a calculation error in the earlier estimate of the impact of the tax cut for the 2001/02 fiscal year. The cost in the current fiscal year will be $1,150 million rather than the $1,350 million reported earlier. The out-year estimates of $1,500 million have not changed;

- Neither the economic forecast nor the revenue and expense forecasts include the effects of the tax cut on the economy. The Minister of Finance has indicated he will table an economic and fiscal update on July 30, 2001. The update is expected to project the impact of the tax cut and other policy changes on the economic forecast and the fiscal forecast; and

- Further detail on the forecasts for CRF revenues, CRF expense and Crown agency net income is provided below.

As illustrated in Chart 13, the Panel finds that the forecast status quo Summary Accounts deficits indicate that there is a serious structural imbalance that represents a threat to the financial health of the province unless appropriate action is taken quickly.

In the Panel's view, the March 2001 budget provided a reasonable forecast of the 2001/02 fiscal situation. The Panel's forecast for 2001/02 is worse than the budget due to a lower economic forecast, softening energy prices and some expected spending increases. The Panel also believes that a larger forecast allowance is warranted because of uncertainties in both the revenue and expense forecasts.

The budget fiscal plan for 2002/03 and 2003/04 (the “out-years”) was not a reasonable forecast in the Panel's opinion. Those forecasts included energy price forecasts that were considerably optimistic and assumptions that significant cost reductions would be realized.
Energy prices are very volatile and there is certainly the possibility that they will remain high or even increase from recent highs over the three year period. However, most forecasters expect prices to come down considerably over the period although the prices are expected to remain above their pre-2000 levels. The Panel believes that the out-year budget assumptions were optimistic.

Regarding the assumption that expenses could be reduced to eliminate any deficit, Ministry of Finance officials have confirmed that through setting targets and making policy changes, it is possible to reduce expenses from status quo levels and that it is standard practice to find ways to manage cost pressures during the budget process. However, since the Panel was asked to prepare a status quo forecast, the Panel has not assumed any policy changes or other actions to reduce expenses from the status quo level. In fact, given budget policy and spending decisions, wage settlements reached in the past year and ongoing collective bargaining, there is considerable upward pressure on expenses in all three years of the forecast period.

**FORECAST ALLOWANCE**

The budget included a forecast allowance of $300 million, a practice that has been in place in British Columbia for several years and was supported by the Enns Report. The forecast allowance is intended to allow the Minister of Finance to produce a fiscal forecast that is neither optimistic or conservative but to introduce a fully disclosed element of conservatism (or optimism) into the budget forecast through the forecast allowance.

It is important that budget fiscal forecasts be conservative because credibility will be damaged if actual results are significantly worse than forecast. The forecast allowance explicitly introduces that conservatism. Measures that reduce the risk of a worse than expected result are sometimes referred to as adding “prudence” to the fiscal forecast.

**Chart 14 – Comparison of Budget to Actual**

If the purpose of the forecast allowance is to increase the chance of achieving the deficit/surplus target, the question is, how large should the forecast allowance be? The 2001/02 budget forecast allowance of $300 million represents about one percent of revenue or expense.

Chart 14 indicates the size of forecast errors when comparing budget to actual results over the past ten years. Given the importance of resource revenues in British Columbia and the volatility of those revenues, it is not surprising that there have been some...
significant errors. The average absolute error over the past five years has been about $1 billion, largely due to recent energy price volatility. Historically variances have been in the 2% to 3% of revenue range.

The provinces of Alberta, Saskatchewan, Manitoba and Ontario as well as the federal government all use mechanisms to add conservatism to their forecasts. These vary from 2% to 4% of revenue (Ontario, Federal and Alberta). Saskatchewan has a 10% Fiscal Stabilization fund.

During meetings with Ministry and Crown agency officials the Panel was provided with information about many situations that have the potential to negatively affect the deficit, especially in terms of increased expense. The major uncertainties are described under the revenue and expense forecast descriptions below. These uncertainties, in aggregate, amount to about $700 million in the current year and to over $1 billion for the out-years. While not all of the events that would give rise to these added costs are likely to occur, this analysis confirms that the risk rises over time. When combined with the risk of revenues being lower than forecast, it suggests that a significant forecast allowance is warranted.

The Panel has included a forecast allowance of $730 million for the remainder of 2001/02 (3% of CRF expense), $1,100 million in 2002/03 (4.3%) and $1,250 million in 2003/04 (4.5%). The lower amount in the current year is consistent with the fact that the first quarter has already passed.

### CRF Revenue Forecast

Table 3 provides the Panel’s status quo revenue forecast as compared to the March 2001 budget. The Panel’s forecast for the current year is lower than the budget forecast primarily because of changes since the budget, including a reduction in projected economic activity and softening energy prices. These factors also affect the out-years but, in the Panel’s opinion, the major factor affecting the out-years’ forecast was that the budget used energy price assumptions that were optimistic at the time of the budget.

As indicated in the budget, the assumptions underlying the revenue forecast are primarily drawn from the economic forecast. The sensitivities provided in the budget documents are reasonable estimates of the sensitivities of the various forecast revenue sources to changes in the assumptions. In general terms, a 1% change in the GDP growth rate can be expected to increase CRF revenue by between $200 and $300 million, assuming that all components of GDP move in tandem.

There are significant uncertainties associated with the revenue forecast, which could make the actual results greater or less than the forecast. On the positive side, economic growth may be greater than forecast, energy prices may not decline as much as expected and forest revenues may be higher than anticipated due to higher prices. It is also conceivable that the resolution of the softwood lumber dispute will generate additional provincial government revenues. There is potential for higher
volumes of oil, gas and mineral activity to generate additional revenue and for amounts owed to BC Hydro by Californian utilities to be repaid.

On the negative side, the softwood lumber dispute and other concerns with the health of the forest industry, especially in the coastal area create a significant risk that revenues will be lower. Electricity, oil and gas prices could decline further than forecast. Economic growth could be lower than expected, especially if the United States economy and/or the economy in the rest of Canada do not perform as well as expected.

**Table 3 – CRF Revenue Forecast**

<table>
<thead>
<tr>
<th></th>
<th>Actual 1999/00</th>
<th>Revised Forecast 2000/01</th>
<th>Budget 2001/02</th>
<th>Revised Forecast 2002/03</th>
<th>Budget 2003/04</th>
<th>Panel Forecast 2004/05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxation revenue</td>
<td>13,378</td>
<td>13,076</td>
<td>13,886</td>
<td>14,323</td>
<td>14,623</td>
<td>15,353</td>
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<tr>
<td>Natural resource revenue</td>
<td>2,517</td>
<td>2,378</td>
<td>3,964</td>
<td>4,110</td>
<td>4,141</td>
<td>3,953</td>
</tr>
<tr>
<td>Other revenue</td>
<td>1,888</td>
<td>1,881</td>
<td>1,872</td>
<td>1,903</td>
<td>1,926</td>
<td>1,925</td>
</tr>
<tr>
<td>Contributions from Crown corporations</td>
<td>1,454</td>
<td>1,448</td>
<td>1,519</td>
<td>1,440</td>
<td>1,487</td>
<td>1,522</td>
</tr>
<tr>
<td>Contributions from the Federal government</td>
<td>2,609</td>
<td>2,717</td>
<td>2,789</td>
<td>2,809</td>
<td>2,978</td>
<td>3,063</td>
</tr>
<tr>
<td>TOTAL CRF REVENUE</td>
<td>21,846</td>
<td>21,500</td>
<td>24,030</td>
<td>24,585</td>
<td>25,155</td>
<td>25,816</td>
</tr>
<tr>
<td>Direct effect of tax cut</td>
<td></td>
<td></td>
<td></td>
<td>(1,150)</td>
<td>(1,500)</td>
<td>(1,500)</td>
</tr>
<tr>
<td>Total CRF Revenue after tax cut</td>
<td></td>
<td></td>
<td></td>
<td>22,862</td>
<td>22,420</td>
<td>23,288</td>
</tr>
</tbody>
</table>

This discussion raises the question of whether increased revenue can contribute to resolving the deficit problem. There are two aspects to that issue – is there capacity to increase revenues directly by increasing tax rates, user fees, etc. and, can economic growth increase revenues?

The performance of the British Columbia economy has lagged the rest of Canada over the past decade. By improving British Columbia’s relative economic performance and becoming more competitive there is potential to improve revenues. Competitiveness can be improved by reducing the regulatory compliance burden imposed by government and addressing tax competitiveness issues. Given the concern about competitiveness, there is little capacity to increase taxes. There may be non-tax revenues sources that could be tapped, such as gaming revenues\(^1\) but that would require a policy decision and government would have to balance the social costs against any fiscal benefits.

Another key factor in British Columbia’s economic performance now and into the future is the uncertainty associated with Aboriginal land claims. Resolving that uncertainty will provide ongoing economic benefits for British Columbia as well as

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\(^1\) British Columbia generates lower gaming revenue per capita than most other provinces.
social benefits. The Panel notes that there are considerable potential expenses associated with resolving land claims but, since settlement costs are amortized over several years, it is unlikely that they will be significant during the forecast period.

**CRF Expense Forecast**

Table 4 presents the Panel’s CRF expense forecast as compared to the March, 2001 budget and the previous two years. The values in the table under “Budget” for 2002/03 and 2003/04 are from an internal, unpublished Ministry of Finance status quo forecast and do not represent budget targets communicated to ministries.

**Table 4 – CRF Expense Forecast**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Health</td>
<td>7,972</td>
<td>8,276</td>
<td>8,680</td>
<td>9,235</td>
<td>9,802</td>
<td>10,300</td>
<td>9,361</td>
<td>9,915</td>
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<tr>
<td>Education</td>
<td>4,349</td>
<td>4,610</td>
<td>4,620</td>
<td>4,779</td>
<td>4,893</td>
<td>4,986</td>
<td>4,779</td>
<td>4,893</td>
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<tr>
<td>Social Development</td>
<td>2,122</td>
<td>2,212</td>
<td>2,200</td>
<td>2,360</td>
<td>2,576</td>
<td>2,784</td>
<td>2,363</td>
<td>2,576</td>
</tr>
<tr>
<td>Advanced Education</td>
<td>1,637</td>
<td>1,777</td>
<td>1,955</td>
<td>1,920</td>
<td>2,037</td>
<td>2,130</td>
<td>1,920</td>
<td>2,037</td>
</tr>
<tr>
<td>Children and Families</td>
<td>1,356</td>
<td>1,501</td>
<td>1,507</td>
<td>1,690</td>
<td>1,803</td>
<td>1,995</td>
<td>1,692</td>
<td>1,803</td>
</tr>
<tr>
<td>Attorney General</td>
<td>1,007</td>
<td>946</td>
<td>1,005</td>
<td>1,003</td>
<td>1,037</td>
<td>1,066</td>
<td>1,057</td>
<td>1,057</td>
</tr>
<tr>
<td>Forests</td>
<td>498</td>
<td>513</td>
<td>560</td>
<td>514</td>
<td>519</td>
<td>517</td>
<td>565</td>
<td>519</td>
</tr>
<tr>
<td>Other Ministries</td>
<td>1,493</td>
<td>1,423</td>
<td>1,503</td>
<td>1,600</td>
<td>1,646</td>
<td>1,675</td>
<td>1,689</td>
<td>1,646</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Other Appropriations:</th>
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<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Debt Service</td>
<td>835</td>
<td>1,009</td>
<td>895</td>
<td>840</td>
<td>885</td>
<td>954</td>
<td>864</td>
<td>995</td>
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<tr>
<td>BC Family Bonus</td>
<td>183</td>
<td>152</td>
<td>152</td>
<td>120</td>
<td>111</td>
<td>111</td>
<td>120</td>
<td>111</td>
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<tr>
<td>Other</td>
<td>(91)</td>
<td>27</td>
<td>(93)</td>
<td>234</td>
<td>210</td>
<td>172</td>
<td>47</td>
<td>203</td>
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<tr>
<td>Required savings$^2$</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(474)</td>
<td>(907)</td>
<td>(907)</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**Total Before One-Time Expenses**

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Pension Accounting Policy</td>
<td>(352)</td>
<td>(368)</td>
<td>(368)</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Asset Write-downs$^2$</td>
<td>1,191</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>

**TOTAL CRF EXPENSE**

CRF expense is forecast to grow at an average annual rate of over 6% over the five year period ending in 2003/04 (see Chart 15). The Ministry of Health, with the largest single budget and a compound annual rate of growth of over 7%, accounts for a large portion of the increase in expenses. It is notable that the Ministry of Education’s expense is growing at over 3% per year in spite of no growth in enrolment.

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$^1$ This is the amount by which status quo expense would have had to be reduced to achieve a balanced budget.

$^2$ Includes debt forgiveness of $1,080 million to the BC Ferry Corporation.
Given the revenue forecasts, these expense increases are not sustainable.

The Panel’s forecast differs from the budget forecast in several significant ways:
- Ministry of Health expenses are expected to be higher than the budget forecast in all three years. In spite of substantial increases to the ministry budget in recent years, there are significant unfunded spending pressures in the ministry that the Panel has recognized in the forecast, including compensation increases;
- Increases in the current year forecast expense in the Ministry of the Attorney General are related to compensation increases and litigation costs;
- Increases in the Ministry of Forests current year forecast expense related to the Doman tenure issue and the costs of defending the softwood lumber countervailing duty case and other litigation and processes;
- Increased interest costs due to the increased deficit forecast by the Panel;
- Lapsed spending authority was assumed to provide savings of 0.5% of total CRF expenses, based on analysis that shows lapsed appropriations over the past ten years of 0.5% to 1.0%; and
- The Panel did not include the budget savings of $474 million and $907 million respectively that were assumed in the out-years in order to reach a balanced budget. These savings were excluded because they would require policy changes.

The Panel’s Terms of Reference require a comment on the assumptions and sensitivities underlying the fiscal forecast. The assumptions and sensitivities detailed in the March 2001 budget seem to be reasonable, although some circumstances have since changed. In terms of assumptions, the Panel has noted that the performance of the economy, while having some influence on expense, is not really a very significant driver of costs. Much government spending can be analyzed by breaking down total spending into unit cost times volume. One of the most significant drivers of the unit cost of government services is wages and salaries. As indicated in the “Fiscal Trends” section of this report compensation costs account for about 54% of expense. Therefore, one of the most important risks associated with the forecast is that wage settlements will exceed provisions included in the forecast.

In health and social services, the volume of services is often measured in terms of “utilization” which means the rate at which the services are accessed by the public.
Increased utilization in the health and social services sectors together with more modest utilization of some of the services provided by the Ministry of Attorney General have contributed to the respective rates of growth of spending in these ministries.

It should be noted that the volume of K-12 education is driven primarily by the school age population and that higher education is driven primarily by government decisions about how much of the demand for advanced education to satisfy. Overall enrolment in K-12 has been declining slightly, although some school districts are experiencing growth. Spending has increased for special needs pupils and for special programs. Reductions in K-3 classroom sizes have also increased cost. Neither the budget forecast nor the Panel’s forecast includes funding for further reduction in classroom size, although the intention to reduce all K-3 class sizes to 18 was indicated by the previous government and has been anticipated in capital spending on schools.

Government has recently increased the number of post-secondary spaces significantly, including spaces in some relatively expensive programs such as high-technology, nursing and medicine. Policy decisions to maintain or increase the rate of spaces made available could generate significant further spending increases in advanced education.

Expenses in the Ministry for Children and Families is driven primarily by the number of children in care and the degree to which those children can be placed in foster care or must be cared for in more expensive group homes. The number of children in care has been growing rapidly and is projected to continue growing.

In the context of the overall budget, the risks and opportunities associated with the rest of government are considerably smaller than they are for the social ministries. Nevertheless, the Panel has noted that expenditure in these other areas has begun to increase after many years of reductions or relatively stable spending.

There are significant risks of higher spending in many areas, especially in the various social ministries, associated with both unit costs and utilization. However, the Panel believes that cost is really only relevant in terms of the results generated from the services those costs represent. As discussed under “Managing for Results,” while it is clear that costs need to be managed, the focus must be on determining what results are most important and focusing on services that yield those results.
Crown Agencies Forecast

Table 5 provides the Panel’s forecast of net income for taxpayer-supported and self-supported Crown Agencies. The major difference between the Panel’s forecast and the budget is an increase in BC Hydro net income in 2001/02 due to higher than expected export profits to date. The out-year forecasts are not materially different from the budget.

There are several significant assumptions and risks (both positive and negative) associated with these forecasts. The following address these on an agency-by-agency basis:

- BC Hydro – the budget forecast of $300 million net income was a government imposed target that was in excess of the BC Hydro’s forecast net income. There was considerable public discussion at the time about whether the target was feasible. In fact, BC Hydro has been earning export profits by using their ability to rapidly start and stop hydroelectric generating capacity to sell during peak periods and buy during off-peak periods. Even though BC Hydro has little surplus electricity, this practice has generated export revenue. Although prices are currently coming down, there is both upside and downside risk to the Panel’s estimate of $375 million net income, which was provided by BC Hydro. In the out-years, the forecasts are based on Ministry of Finance targets, which are in excess of BC Hydro’s internal forecasts. The results will depend on developments in North American electricity markets over the next two years, which are very difficult to predict.

- ICBC – the forecast includes targets set by the provincial government that is equal to ICBC’s internal forecast for the current year and are in excess of ICBC’s internal forecast in the out-years. There is a risk that claims costs will exceed the level required to meet these targets unless rates are increased.

- Forest Renewal BC – the net loss forecast is based on government set targets rather than the corporation’s business plan. Unless expenditure is reduced or additional income is forthcoming, the corporation will consume its reserves over the next two years. The Panel notes that the corporation is currently under review. Since the corporation’s income is primarily stumpage revenue, the corporation is subject to the same risks as stumpage revenue related to the softwood lumber countervailing duty case in the United States and concerns about the coastal forest industry.

- BC Rail – the corporation is dependent on the forest industry and subject to the same risks as the forest industry. It has also indicated to government that structural changes to the corporation may be required to ensure its long-term sustainability.
### Table 5 – Crown Agencies Fiscal Forecast

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxpayer-supported Crown Corporations and Agencies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>BC Buildings Corp.</td>
<td>45</td>
<td>62</td>
<td>51</td>
<td>39</td>
<td>46</td>
<td>70</td>
<td>40</td>
<td>46</td>
<td>70</td>
</tr>
<tr>
<td>BC Ferry Corp.</td>
<td>(299)</td>
<td>(10)</td>
<td>10</td>
<td>3</td>
<td>7</td>
<td>8</td>
<td>3</td>
<td>10</td>
<td>13</td>
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<tr>
<td>BC Trans. Financing Authority</td>
<td>22</td>
<td>(1)</td>
<td>1</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forest Renewal BC</td>
<td>1</td>
<td>(52)</td>
<td>(97)</td>
<td>(139)</td>
<td>(65)</td>
<td>(48)</td>
<td>(107)</td>
<td>(65)</td>
<td>(46)</td>
</tr>
<tr>
<td>Other Crowns and Agencies</td>
<td>(44)</td>
<td>(16)</td>
<td>26</td>
<td>(7)</td>
<td>(1)</td>
<td>-</td>
<td>(7)</td>
<td>2</td>
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<tr>
<td></td>
<td>(275)</td>
<td>(17)</td>
<td>(9)</td>
<td>(104)</td>
<td>(12)</td>
<td>33</td>
<td>(71)</td>
<td>(7)</td>
<td>39</td>
</tr>
<tr>
<td>Less: Contributions to CRF</td>
<td>(78)</td>
<td>(62)</td>
<td>(72)</td>
<td>(18)</td>
<td>(20)</td>
<td>(30)</td>
<td>(49)</td>
<td>(20)</td>
<td>(30)</td>
</tr>
<tr>
<td>Less: BCFC debt forgiveness</td>
<td>1,080</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Less: Accounting changes¹</td>
<td>(131)</td>
<td>(227)</td>
<td>(185)</td>
<td>(191)</td>
<td>(186)</td>
<td>(174)</td>
<td>(191)</td>
<td>(186)</td>
<td>(174)</td>
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<tr>
<td><strong>Total Taxpayer Supported</strong></td>
<td>596</td>
<td>(306)</td>
<td>(266)</td>
<td>(313)</td>
<td>(218)</td>
<td>(171)</td>
<td>(311)</td>
<td>(213)</td>
<td>(165)</td>
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<tr>
<td><strong>Self-supported commercial:</strong></td>
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<td></td>
<td></td>
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<tr>
<td>BC Hydro</td>
<td>545</td>
<td>412</td>
<td>795</td>
<td>300</td>
<td>400</td>
<td>400</td>
<td>375</td>
<td>400</td>
<td>400</td>
</tr>
<tr>
<td>Liquor Distribution Branch</td>
<td>617</td>
<td>620</td>
<td>635</td>
<td>616</td>
<td>625</td>
<td>631</td>
<td>616</td>
<td>625</td>
<td>631</td>
</tr>
<tr>
<td>BC Lottery Corp.</td>
<td>532</td>
<td>542</td>
<td>550</td>
<td>585</td>
<td>613</td>
<td>649</td>
<td>585</td>
<td>613</td>
<td>649</td>
</tr>
<tr>
<td>BC Railway Company</td>
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<td>40</td>
<td>(7)</td>
<td>18</td>
<td>40</td>
<td>57</td>
<td>1</td>
<td>40</td>
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<td>Insurance Corp. of BC</td>
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<td>3</td>
<td>131</td>
<td>75</td>
<td>50</td>
<td>50</td>
<td>35</td>
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<tr>
<td>Other</td>
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<td>6</td>
<td>7</td>
<td>9</td>
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<td>9</td>
<td>9</td>
<td>16</td>
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<td></td>
<td>1,209</td>
<td>1,659</td>
<td>2,110</td>
<td>1,601</td>
<td>1,737</td>
<td>1,803</td>
<td>1,621</td>
<td>1,737</td>
<td>1,803</td>
</tr>
<tr>
<td>Less: Contributions to CRF</td>
<td>(1,376)</td>
<td>(1,386)</td>
<td>(1,447)</td>
<td>(1,422)</td>
<td>(1,467)</td>
<td>(1,492)</td>
<td>(1,422)</td>
<td>(1,467)</td>
<td>(1,492)</td>
</tr>
<tr>
<td>Other accounting adjustments²</td>
<td>(23)</td>
<td>(145)</td>
<td>(235)</td>
<td>(156)</td>
<td>(162)</td>
<td>(173)</td>
<td>(127)</td>
<td>(162)</td>
<td>(173)</td>
</tr>
<tr>
<td><strong>Total Self-Supported</strong></td>
<td>(190)</td>
<td>128</td>
<td>428</td>
<td>23</td>
<td>108</td>
<td>138</td>
<td>72</td>
<td>108</td>
<td>138</td>
</tr>
<tr>
<td><strong>Total Net Contribution</strong></td>
<td>406</td>
<td>(178)</td>
<td>162</td>
<td>(290)</td>
<td>(110)</td>
<td>(33)</td>
<td>(239)</td>
<td>(105)</td>
<td>(27)</td>
</tr>
</tbody>
</table>

¹ Primarily amortization of the cost of highways transferred to the BC Transportation Financing Authority.
² Includes transfers of gaming revenue to charities and municipalities and adjustment to place BC Rail and ICBC on a fiscal year basis.
CAPITAL EXPENDITURE

Adequacy of the Capital Stock

As described in the “What is a Deficit or Surplus?” section of this report, British Columbia has adopted accounting principles similar to the private sector in accounting for its investment in capital assets. Capital assets are assets that can be used over time to provide a benefit. Examples are schools, health facilities, vehicles, medical equipment and computer hardware and software. Note that Crown lands that have not been acquired for value (most of the land base in the province) are not treated as capital assets.

These assets are accounted for by accumulating their cost on the balance sheet and recognizing the fact that they are used over time by amortizing the cost over the life of the asset. This treatment is consistent with Generally Accepted Accounting Principles for the public sector in Canada, although no other jurisdictions in Canada fully capitalize their assets as yet.

When assets are not capitalized their cost is, by default, treated as an expense during the year in which they are acquired. Where jurisdictions choose not to capitalize assets they may have a disincentive to acquire assets because of their impact on the deficit/surplus and consequently can find themselves with aging and ineffective buildings and equipment that cause reduced service and increased operating costs. An adequate capital stock is required for efficiency and effectiveness.

On the other hand, when assets are capitalized their cost is, by default, treated as an expense during the year in which they are acquired. Where jurisdictions choose not to capitalize assets they may have a disincentive to acquire assets because of their impact on the deficit/surplus and consequently can find themselves with aging and ineffective buildings and equipment that cause reduced service and increased operating costs. An adequate capital stock is required for efficiency and effectiveness.

Chart 16 – Capital Spending by Agency

Estimated Gross 2001/02 Capital Expenditures
$3.13 billion

<table>
<thead>
<tr>
<th>Agency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>BC Hydro</td>
<td>20%</td>
</tr>
<tr>
<td>Other taxpayer-supported</td>
<td>10%</td>
</tr>
<tr>
<td>BCTFA</td>
<td>11%</td>
</tr>
<tr>
<td>RTP2000</td>
<td>11%</td>
</tr>
<tr>
<td>BCFerries</td>
<td>3%</td>
</tr>
<tr>
<td>Health</td>
<td>13%</td>
</tr>
<tr>
<td>Education</td>
<td>16%</td>
</tr>
<tr>
<td>Other Capital Plan</td>
<td>2%</td>
</tr>
<tr>
<td>BC Rail</td>
<td>2%</td>
</tr>
<tr>
<td>ICBC</td>
<td>1%</td>
</tr>
<tr>
<td>Properties</td>
<td>3%</td>
</tr>
<tr>
<td>Other self-supported commercial</td>
<td>8%</td>
</tr>
</tbody>
</table>

The current system … seems to provide a reasonably rigorous capital budgeting process for those projects included in the capital plan.

On the other hand, when assets are capitalized capital may be viewed as being almost free because the annual impact on the deficit of a particular project is small. That may result in decisions to acquire capital assets that do not deliver services efficiently and effectively. Capital spending is usually financed largely with debt. Unchecked capital spending can quickly increase debt levels, damaging credit ratings and fiscal credibility. Therefore, it is important that there be a rigorous capital approval process to limit overall
capital spending to affordable levels and to ensure that capital spending decisions are based on good business cases that evaluate the costs and benefits of the projects.

There are effectively three categories of capital projects in British Columbia, each of which is subject to its own approval process. Most of the capital spending in Ministries and taxpayer-supported Crown agencies is part of the Consolidated Capital Plan, accounting for about $1.9 billion in capital expenditure in 2001/02. The Capital Division of the Ministry of Finance manages the capital plan. About $300 million in annual capital spending is outside the capital plan, such as spending approved by the BC Housing Management Commission on social housing. The remainder of the capital expenditure takes place in commercial Crown agencies and is subject to approval by their boards of directors and, above certain limits, by Treasury Board. Total capital expenditure in all categories in 2001/02 is expected to be about $3 billion.

Capital budgeting in British Columbia has evolved considerably since it was first put in place in the early 1990’s. Many of the changes were as a result of high profile problems such as the fast ferries and the tower at Vancouver General Hospital that stood empty for several years because of lack of operating funding. In our view the current capital budgeting process appears to be appropriately rigorous.

Is the planned level of capital spending adequate to enable government services to be effectively and efficiently delivered in future? Based on the review by the Panel, the following observations can be made:

- Capital Plan – the Capital Plan is a plan rather than a forecast. Specific approved capital projects are subject to changes in approval decisions. As discussed below, there are pressures which may result in increased capital spending or reallocation of capital spending. In the Panel’s debt forecast, the budget forecast for capital spending of about $1.9 billion per year has been used as the status quo level.

- Education – significant capital spending throughout this decade together with a statutory requirement to provide a space for every child and declining enrolment have combined to provide an adequate stock of schools. The approved capital plan seems to meet the future needs of the sector.

- Health – given changing methodologies and technologies in healthcare across Canada, uncertainties with respect to the adequacy of the present capital stock are to be expected. As approaches to healthcare shift, the capital needed to support the changes inevitably lags.

- Advanced education – for the past several years there has been a voluntary moratorium on major capital projects at established institutions. The result has been a significant increase in the usage of existing facilities as enrolment increases have been accommodated within the existing capital stock. Buildings are aging at some institutions, such as UBC. As the moratorium expires pressure will build for construction of new buildings and renovation of existing
buildings. The capacity to further increase the utilization of existing facilities will vary from institution to institution.

- Rapid transit – the Millennium Line project is nearing completion with a reasonable probability that it will be completed substantially within budget. The next phase to Coquitlam depends upon agreement being reached with Translink. The current intent is that TransLink will be responsible for $650 million of the capital costs of the Coquitlam line with the province responsible for the remainder. There are serious future issues associated with rapid transit in the Lower Mainland, both in terms of coming to agreement on the Coquitlam line and the need for rapid transit from Richmond and the airport, particularly in the event that the Vancouver/Whistler Winter Olympic bid is successful.

Governance of transportation in the Lower Mainland is a particular problem that has come to our attention. It is unclear who is responsible and accountable, especially for needed capital improvements to this strategically important system.

There may also be an accounting issue associated with the treatment of the Expo line as an asset of the province leased to TransLink rather than an asset of TransLink. This issue is currently being discussed by the Comptroller General and the Auditor General. Since the province plans to treat the $1.7 billion cost of the Millennium line in the same fashion when it is complete, if the accounting treatment were to be changed there would be a significant negative impact on the 2001/02 deficit/surplus.

- Highway Transportation – the BC Transportation Financing Authority and the Ministry of Transportation have indicated that the current stock and planned spending on major highways is generally adequate but there may be a need to expend funds to rehabilitate secondary roads. Definition of the extent of this problem is in process. In addition, a successful Olympic bid would result in significant capital requirements to upgrade the Sea to Sky Highway.

**Deferred Maintenance**

One of the issues that has been raised in the course of the review is deferred maintenance. In general, the cost of maintaining capital assets is treated as an expense when the cost is incurred. As a result, when there is pressure to reduce spending, maintenance is often one of the easiest items to cut since there is usually little immediate impact on service delivery. However, if maintenance is deferred for too long, the asset can start to deteriorate and the cost of reversing the damage can increase rapidly. In addition, service delivery will be affected if the building or equipment becomes less useful.

It has recently been learned that in some of the social capital areas a significant amount of maintenance spending has been treated as a capital cost instead of as an operating expense and that some capital spending, especially equipment purchases, have been treated as operating costs. The net impact of the changes in 2001/02 is expected to be a transfer of up to $270 million from capital to operating. To the
extent that the funds transferred to operating budgets are combined with other operating funds for management purposes, that funding could be at risk of being appropriated for non-maintenance purposes, increasing any deferred maintenance.

Has there been a significant amount of deferred maintenance and what can be done to prevent it from occurring? There appears to be deferred maintenance of about $400 million in the advanced education sector and about $120 million in the health sector. These amounts are significant in absolute terms but relatively small when considered in terms of resolving the issue over several years in the context of the annual $1.9 billion in ministry and taxpayer-supported Crown agency capital expenditures. There does not seem to be a deferred maintenance issue associated with the capital stock directly managed by ministries, BCBC or in the K-12 education sector.

These are, at best, estimates. Work is currently underway to develop more definitive maintenance standards to assist in appraising the extent of deferred maintenance.

There are several ways that deferred maintenance can be prevented, including providing endowments earmarked for maintenance when capital projects are undertaken, and using various mechanisms to limit the ability of government agencies to use funds targeted for maintenance for other operating purposes. Another approach, consistent with the discussion below on measuring and managing for results, is not to focus on the input of budget funding provided for maintenance but rather to focus on the result of managing the capital assets to maximize their lifecycle benefits in terms of service provision.

Given the importance of an efficient and effective capital stock to the government’s ability to provide services, the Panel believes that that mechanisms should be put in place to ensure assets are appropriately managed, to avoid future deferred maintenance and to correct existing maintenance deficiencies.

**BALANCE SHEET REVIEW**

The balance sheet is the financial statement that records the value of various assets and liabilities as of a specific date, most often the year-end. Assets include cash on hand, amounts receivable (such as taxes owing but unpaid), financial assets such as loans and investments in shares and capital assets (the capital stock). Liabilities include amounts payable (for example where payment has not been paid for an item purchased), obligations to pay for the pensions of public sector employees and amounts borrowed to finance operations, investments or capital spending. Unless these items are accurately represented in the financial statements, the fiscal situation is not fairly represented.
Contingent and Unrecorded Liabilities

The financial credibility of government requires confidence that all liabilities are recorded. Adding a liability to the balance sheet often means that expenses will be increased.

British Columbia accounting policy provides for recognition of liabilities consistent with Generally Accepted Accounting Principles. While judgement is exercised in applying the policy, the independent role of the Auditor General and the ongoing dialogue between the offices of the Comptroller General and the Auditor General generally ensure appropriate reporting.

Contingent liabilities are liabilities that may or may not arise, although their possibility can be identified. For example, a lawsuit may result in the province owing an amount depending on the judgement or settlement. Accounting principles require contingent liabilities to be disclosed in the notes to the financial statements. It may be important that disclosure not prejudice government’s interest by revealing details about what it believes may have to be paid with respect to various actions or negotiations. When there is a significant likelihood that an amount will have to be paid, the practice is to record the amount as a liability and recognize the appropriate expense.

Concerns have been expressed that the 2001/02 budgeted surplus does not provide for expected costs associated with certain legal actions. On the basis of responses to our queries, it appears that estimated costs have been appropriately included in budgeted expenses.

The Panel has not become aware of any material unrecorded liabilities except for a potential liability associated with health care benefits for certain retired public sector employees. This issue is being discussed currently between the Comptroller General and the Auditor General.

Valuation of Investments

Also critical to the credibility of financial statements is the appropriate valuation of financial assets. The value of these assets may be affected by market prices and changing circumstances. Financial assets include amounts invested to generate income and loans and other investments made to promote economic development or for other purposes, such as student loans to post-secondary students. In addition, the government may guarantee loans made by others or provide indemnities which obligate the province to make payments in certain circumstances.

The Panel found no reason to question the valuation allowance for loans and investments provided for in the budget.

Nevertheless, the Panel notes that there is considerable uncertainty around the province’s investment in Skeena Cellulose. The government has indicated that the investment is under review and various options are being considered. It is possible
that the result will affect the valuation of Skeena Cellulose and associated loans, guarantees and indemnities (as well as the deficit), depending on government’s decision.

**Pension Liabilities**

The provincial government has an obligation to ensure that funds are available for pensions of public servants, including those in education and healthcare, as they become eligible to receive them. At one time, governments did not fund pensions but made payments from current revenues. At any point in time a substantial future liability existed. Governments now set aside money in pension funds to cover future pension costs. Nevertheless, most governments in Canada continue to have a gap between the estimated future capacity of the pension fund holdings to fund pensions and the future expected pension costs – this gap is termed an unfunded pension liability.

As required by Generally Accepted Accounting Principles, British Columbia records its unfunded pension liabilities on its balance sheet. Pension funds are actuarially valued periodically and the change in the unfunded liability is recorded as an accounting adjustment over time. This is an appropriate accounting practice, but it does give rise to adjustments that are difficult to explain due to the complex nature of pension finances and actuarial valuations.

In the 2001/02 budget there was a $1.4 billion addition to the surplus forecast arising from the change to joint trusteeship for public sector pensions. Prior to the current year, pension funds were held in trust by the provincial government, which had control of how pension funds were invested and what the benefit and premium levels were, subject to agreements reached through collective bargaining.

Governance of the pension plans is being changed from the government as sole trustee to joint trusteeship under which the government and employees have joint responsibility for the pension plans. The joint trusteeship agreements require that the parties must manage the pension plans to keep them in balance over time by increasing or decreasing benefits and/or premiums in response to changes in the valuation of the funds and future pension liabilities.

This has resulted in two changes. The first is that all the pension plans are being revalued as of the date of the change, resulting in gains from the performance of financial markets in the past years being crystallized. The second is that the government’s sole liability for future pension costs has been reduced to a shared liability. These two factors have reduced the unfunded pension liability carried on the provincial balance sheet by $1.4 billion.

There may be a perception that this $1.4 billion gain was a convenient and artificial increase in the surplus. While it is clearly a one-time entry and is not part of the structural financial position, the Panel finds that this reporting treatment is a legitimate and appropriate recognition of changes in the provincial government’s financial position, in particular the value of its unfunded pension liabilities.
The move to joint trusteeship is a substantive change to the way pensions are managed with significant implications for public sector employees and there is concern with the lack of public discussion and debate prior to the change.

DEBT FORECAST

Debt is the amount borrowed by government from others. There are effectively two reasons for the government to borrow – to finance its operations and to finance capital spending. There are also two types of government debt – taxpayer-supported debt borrowed on behalf of direct government and taxpayer-supported Crown agencies; and, self-supported debt, borrowed on behalf of commercial or self-supporting Crown agencies.

In the section “What is a Deficit or Surplus?” the elements of public sector accounting in British Columbia are explained, including the fact that capital assets are expensed over their useful life through amortization. Within this accrual accounting framework, there is not a direct relationship between the deficit/surplus, which measures the results of operations during a fiscal year, and the change in the debt, which measures the amount of borrowing or debt repayment undertaken during the year. In order to reconcile these two concepts one must first adjust the deficit or surplus from an accrual basis to a cash basis and then add changes in capital assets and cash related changes in other balance sheet items.

Table 6 provides the reconciliation of the deficit forecast and expected capital spending to the change in debt for the period 1999/00 to 2003/04. It raises an interesting question – if amortization represents the expense associated with using up the capital stock over its life, why is amortization so much less than net capital spending? For example, in 1999/00 amortization was $575 million and capital spending was $1.9 billion.

There are two reasons. One is that capital assets are recorded at cost and the replacement cost of most assets is well in excess of their original cost, especially for buildings or vessels with 30 to 50 year useful lives - and amortization is based on cost. Another reason is that population growth, technology changes, other demand drivers and service delivery changes mean that much capital spending is for additional facilities that are not simply to replace existing assets.

The Panel is forecasting increased deficits which is the main reason that taxpayer-supported debt is significantly higher in the Panel’s forecast than in the forecast provided in the budget.
Table 6 – Change in Taxpayer-Supported Debt

<table>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CRF Surplus (Deficit)</td>
<td>(354)</td>
<td>1,415</td>
<td>290</td>
<td>110</td>
<td>33</td>
<td>(445)</td>
<td>(1,835)</td>
<td>(2,493)</td>
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<td>Amortization</td>
<td>575</td>
<td>600</td>
<td>626</td>
<td>684</td>
<td>708</td>
<td>626</td>
<td>684</td>
<td>708</td>
</tr>
<tr>
<td>Pension Adjustment</td>
<td>(130)</td>
<td>(58)</td>
<td>(86)</td>
<td>(86)</td>
<td>(86)</td>
<td>(86)</td>
<td>(86)</td>
<td>(86)</td>
</tr>
<tr>
<td>Adjusted CRF Surplus (Deficit)</td>
<td>91</td>
<td>1,957</td>
<td>830</td>
<td>708</td>
<td>655</td>
<td>95</td>
<td>(1,237)</td>
<td>(1,871)</td>
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<tr>
<td>Change in Working Capital</td>
<td>(81)</td>
<td>2,425</td>
<td>(306)</td>
<td>(400)</td>
<td>(400)</td>
<td>(306)</td>
<td>(400)</td>
<td>(400)</td>
</tr>
<tr>
<td>Taxpayer-Supported Capital Spending</td>
<td>(1,899)</td>
<td>(1,981)</td>
<td>(1,735)</td>
<td>(1,910)</td>
<td>(1,872)</td>
<td>(1,735)</td>
<td>(1,910)</td>
<td>(1,872)</td>
</tr>
<tr>
<td>Debt Decrease (Increase)</td>
<td>(1,980)</td>
<td>444</td>
<td>(1,211)</td>
<td>(1,602)</td>
<td>(1,617)</td>
<td>(1,946)</td>
<td>(3,547)</td>
<td>(4,143)</td>
</tr>
<tr>
<td>Total Taxpayer-Supported Debt</td>
<td>24,930</td>
<td>24,486</td>
<td>25,670</td>
<td>27,272</td>
<td>28,889</td>
<td>26,432</td>
<td>29,979</td>
<td>34,122</td>
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<tr>
<td>GDP</td>
<td>118,783</td>
<td>125,100</td>
<td>130,190</td>
<td>134,345</td>
<td>139,560</td>
<td>129,900</td>
<td>133,100</td>
<td>138,920</td>
</tr>
<tr>
<td>Debt/GDP</td>
<td>21.0%</td>
<td>19.6%</td>
<td>19.7%</td>
<td>20.3%</td>
<td>20.7%</td>
<td>20.3%</td>
<td>22.5%</td>
<td>24.6%</td>
</tr>
</tbody>
</table>

Taxpayer-supported government debt represents an intergenerational transfer. Since debt must be repaid in the future, it transfers current costs to future generations. To the extent that debt is attributable to an operating deficit the result is that current costs are being passed on to future taxpayers. However, to the extent that debt is used to finance capital spending, it allows the costs of using the capital (debt repayments and interest) to be matched with the future benefits from the use of the capital.
This suggests that not all debt is bad, but what is the right level of debt? Often the issue is put in terms of debt as a proportion of GDP. Chart 17 shows how taxpayer-supported debt/GDP has changed from 1995/1996 to 2001/2001 for the provinces.

The vertical line shows what the level would be by 2003/04 according to the Panel’s forecast. It shows that British Columbia would go from the second lowest level in Canada to about fourth lowest (depending on what happens in other jurisdictions).

Given the forecasted rate of increase in taxpayer-supported debt and the fact that much of the increase is due to the structural deficit, the forecasted level of debt is a concern.

 ACCOUNTING POLICY

Is Current Financial Disclosure Sound?

The purpose of this review is to provide a credible baseline of the provincial financial situation. For the Panel to do that, we have considered whether financial information provided by the provincial government is a fair representation of the actual financial situation.

British Columbia is a leader in Canada in terms of its implementation of Generally Accepted Accounting Principles for the public sector. A combination of progressive accounting practices already being implemented and the implementation of most of the recommendations of the Enns Report through the Budget Transparency and Accountability Act have resulted in a generally sound basis for the provision of credible financial information. The Panel commends the province on the progress made to date.

That does not mean that financial disclosure could not be improved or that there are not areas of disagreement between the Auditor General and the Ministry of Finance on accounting issues. However, the Panel did not find any significant accounting policy issues that called the credibility of financial disclosure into question other than those noted below.

Reporting Entity

The reporting entity is the set of agencies included in the provincial government accounts. One of the recommendations of the Enns Report that was not implemented was that:

“Legislation require that the reporting and budgeting entity must be the (set of) … public bodies that meet the Generally Accepted Accounting Principles criteria for inclusion in the entity.”
This is the most significant departure of current British Columbia accounting policy from Generally Accepted Accounting Principles. The result of adopting this recommendation would be that some or all of the SUCH sector would be brought within the reporting entity and their revenues and expenses consolidated in calculating the deficit or surplus.

There are arguments on both sides of this issue. One criteria for inclusion is the control that government has over the operations of the agency. If government controls the agency, then government is ultimately accountable and including the agency in the government reporting entity would recognize that accountability.

Arguments against including SUCH sector agencies that meet the criteria include:

• in spite of the criteria, these are really independent agencies that are locally accountable and including them in the reporting entity would reduce the agencies’ own local accountability;

• it would be inappropriate and unfair to include some agencies but not all if different agencies would be treated differently under the criteria; and

• the financial information needed to budget and report on these agencies is not now available in a standard format.

In fact, because virtually all of the agencies involved are required to have balanced budgets each year, the impact of including the SUCH sector on the deficit or surplus is small and usually would result in an overall improvement in the deficit/surplus. Nonetheless, on balance the Panel believes that the reporting entity should be determined by applying Generally Accepted Accounting Principles. The Panel recognizes that this change may require several years to fully implement.

**Budget Consolidation of Taxpayer-Supported Crown Agencies**

There is one other recommendation in the Enns Report that has not been implemented and that the Panel believes should be pursued. Specifically, the recommendation is:

> “Legislation require that the estimates and budget information be prepared in accordance with the province’s accounting policy, including policies on the reporting entity and consolidation …”

Under Generally Accepted Accounting Principles, taxpayer-supported Crown agencies should be consolidated in the Summary Accounts.² That means that the revenues and expenses of the agencies should be combined with government’s revenues and expenses (eliminating payments among the agencies and government) when calculating the deficit or surplus.

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² Under Generally Accepted Accounting Principles self-supporting Crown agencies, as distinct from taxpayer-supported Crown agencies, are not consolidated and their net income is included as a source of Summary Accounts revenue with appropriate accounting adjustments.
Current provincial accounting policy is consistent with Generally Accepted Accounting Principles in this respect and the Public Accounts are prepared accordingly. However, the budget fiscal forecast is presented in a different way. Table 1 adopts the presentation used in the budget, under which the CRF expense is deducted from CRF revenue to calculate the CRF balance, to which the net income of taxpayer supported and self-supporting Crown agencies is added to calculate the Summary Accounts deficit or surplus. The resulting value for the Summary Accounts deficit/surplus is correct but the calculation does not provide a value for Summary Accounts revenue and expense. These are also important fiscal indicators that should be evident from the budget presentation, as they are in the Public Accounts.

The Panel recommends that the change in the budget summary table presentation be made for the 2002 budget.

Other Accounting Issues

The Panel notes that appropriate accounting policies and practices are crucial for the financial credibility and accountability of government. It is important that not only are results defensible in terms of professional accounting standards but also that the accounting treatment which most fairly captures the substance of each transaction is used. As a general principle, accounting policy should not drive government policy, although it is sometimes the case that transactions are structured specifically to generate a certain desired accounting treatment.

The Panel recommends that the government consider establishing an independent accounting policy advisory committee to address this issue. Such a committee would include non-government accounting professionals and respected business people. It would advise government on accounting issues brought to its attention by government or by outside observers.

MANAGING FOR RESULTS

As indicated above, the Panel believes that the status quo forecasted deficits for the coming fiscal years represent a serious situation for the provincial government. The Panel also feels that there is scope for a made-in-BC solution that focuses on solutions that maintain key services, improve revenues and control costs instead of arbitrarily cutting services as has been done in other jurisdictions. Without effective action soon, the result will inevitably be more draconian and harmful across-the-board service cuts.

This section of the report examines the role that can be played by focusing on results.
Comprehensive Review

In conducting its review, the Panel was struck by the fact that for the past several years the budget process has essentially looked only at incremental changes in expense budgets, either up or down. However, the Panel believes that in order to address the serious fiscal situation now facing the province, the government must conduct a complete review so that future budgets can be based on a clear understanding of program objectives and expected results.

The government has already indicated that it intends to undertake such a review. The Panel believes that any such review should include the following features:

• the review should be broadly based focusing on priorities;
• there should be a comprehensive review of expense, revenue and regulatory programs and of the organizational structure;
• the review should be based on an examination of what results are currently being sought and what results the current government believes should be sought;
• options should be considered to find the best way of achieving the results, including an analysis of the benefits and costs from both a fiscal perspective and from the perspective of the economy and society as a whole.

The Panel believes that this type of review has the potential to identify:

• services that are no longer needed because they do not yield desired results;
• alternative ways to deliver services that yield results but cost less and/or achieve better results; and
• ways to make British Columbia more competitive by reducing the regulatory burden while maintaining or improving benefits such as health, safety and environmental protection.

The purpose of the review would not be to cut key services or to introduce across-the-board spending cuts. The review would provide a basis for rationally prioritizing services to determine which to cut first.

Accountability for Results

The Panel also noted the Enns Report recommendations directed towards changing public sector management from being primarily focused on controlling inputs to a focus on measuring results and being accountable for results. This approach has become widespread in both the private sector and in the public sector throughout North America. Prior to the Enns Report some work in this area had been undertaken in the provincial government with little result. The Budget Transparency and Accountability Act implemented the Enns Report recommendations, primarily by requiring that three year “performance plans” and corresponding annual reports be issued each year beginning in 2001/02. These plans and reports must identify measurable results, set targets and report on what results were achieved.
The experience of the Panel members in implementing this type of approach in private sector organizations has highlighted two key points:

- it takes time for managing for results to become effective, in the order of three to five years; and
- success depends on senior management’s commitment to the concept and strong leadership in defining strategic objectives and priorities.

The Panel believes a comprehensive review as described above would establish the strategic basis needed to make managing for results effective. The Panel also believes that a critical and constructive review of Ministry and agency performance plans can result in a more rapid and effective implementation.
APPENDIX A – TERMS OF REFERENCE

Fiscal Review Panel
Terms of Reference

The mandate of the Fiscal Review Panel is to undertake a financial review and to report to the public by July 31, 2001 on the financial situation of the provincial public sector, to provide context for the government’s budget and public policy decisions. This is neither an operational nor a financial audit such as the Auditor General would undertake.

The financial review will include development of a “status quo” forecast of the fiscal situation for the next three fiscal years (fiscal 2001/02 to 2003/04) and a comprehensive survey of the material assumptions and accounting, reporting and fiscal issues with which the government may be faced in the medium-term. A “status quo” forecast is a forecast that assumes no policy changes, providing the context within which policy changes can be developed and considered by government.

The scope of the review is intended to cover the direct provincial government and all of the Crown corporations, agencies and other entities that are included in the provincial Summary Accounts or that the Panel believes should be considered for inclusion in the reporting entity.

In the short timeframe specified, the Panel is expected to accept and rely upon the information provided by professional public servants. All government ministries and agencies are being directed to provide the Panel with the information required to undertake the review in accordance with these terms of reference.

The review is expected to include, but not be limited to, answers to the following questions:

• For fiscal years 2001/02 through 2003/04 what is the most likely forecast of revenues, expenditures, deficit/surplus, assets, liabilities and debt on a Summary Accounts basis assuming no policy changes?
• To what extent does the status quo forecast reflect the ongoing (structural) fiscal situation and to what extent are the results influenced by one-time or extraordinary events?
• What are the material economic forecast assumptions, including assumptions about commodity prices, that underlie the fiscal forecast, what are the main uncertainties associated with the economic forecast and how sensitive is the fiscal forecast to changes in the economic forecast?
• By government ministry/agency, expenditure program area and revenue source, what are the material assumptions and fiscal issues affecting the operating results (i.e. revenue, expenditure and deficit/surplus forecast) and how sensitive are the results to the assumptions?
• What are the assumptions and fiscal issues affecting the forecast of balance sheet accounts such as debt, financial and capital assets and how sensitive are the results to the assumptions?
• Is there a gap between the existing capital stock and the capital stock needed to deliver current services and, if so, what are the fiscal implications?
• Given the assumptions and sensitivity analysis, what is an appropriate prudence factor to include in the fiscal forecasts?
• Other questions that the Panel considers to be relevant to the mandate described above.

May 25, 2001
APPENDIX B – PANEL MEMBERS

Gordon R. Barefoot, Chair
Gordon R. Barefoot, CA, Chair of the Fiscal Review Panel, is Senior Vice President, Planning and Development of BC Gas Inc. He is responsible for strategic planning activities and development initiatives for BC Gas Inc. and its subsidiaries and has oversight responsibility for the company's major non-regulated investments and subsidiaries. Prior to joining BC Gas in 1998, Mr. Barefoot was a partner with Ernst and Young Management Consultants in Vancouver, Edmonton, Winnipeg and Toronto, most recently as Practice Director in Vancouver and National Leader of the Utilities Practice. He received his Chartered Accountant designation in 1975 and became a Certified Management Consultant in 1983. Mr. Barefoot is also a member of the BC Board of the Victorian Order of Nurses and Chair of the Finance Committee of the Board of Vancouver Community College.

Linda Coady
Linda Coady became Vice President of Environmental Affairs for Weyerhaeuser’s predecessor in coastal BC, MacMillan Bloedel, in 1994, and is currently Vice President of Environmental Enterprise for the BC Coastal Group of Weyerhaeuser. She has worked on environmental, aboriginal and trade issues in the BC forest industry for the past 20 years and been involved in a series of challenging initiatives aimed at integrating improved environmental performance and changing social values into her company’s overall business strategy. Ms. Coady is a Director of Iisaak (ee-sock) Forest Products Ltd., a joint venture in eco-forestry between Weyerhaeuser and Nuu-Chah-Nulth First Nations in Clayoquot Sound. She is also a Director of the Marmot Recovery Foundation and a recipient of a BC Ethics in Action Award for leadership in corporate social responsibility. She has a BA in Political Science from the University of British Columbia.

John Cowperthwaite
John Cowperthwaite, CA has been a Partner with Ernst & Young LLP since 1972 and is currently the Managing Partner for Ernst & Young LLP in Vancouver with responsibilities for many of the clients of the Firm in British Columbia. He is active in professional and community service. Currently he is the Chair of the United Way of the Lower Mainland and Second Vice-President of the Institute of Chartered Accountants of British Columbia.

Tim Duholke
Tim Duholke, CA is a partner in Sheinin & Co., a Vancouver based professional firm that specializes in providing advice on taxation and related financial matters. Mr. Duholke received a Bachelor of Commerce degree from the University of Alberta in 1976 and qualified as a chartered accountant in 1978. Mr. Duholke is a governor and member of the Executive Committee of the Canadian Tax Foundation. He has also chaired and served on various committees with the Institute of Chartered Accountants of B.C. He has been involved in many community activities including acting as Chair of the Western Lacrosse Association and is currently the Treasurer of the Michael J. Fox Theatre.
Hugh Gordon
Hugh Gordon, FCA, has been Chairman of the Board of Governors and Chancellor of Royal Roads University since 1995. He retired from KPMG in 1998 where he had been a tax partner with the firm and its predecessor firms in Calgary, Victoria, Toronto and Vancouver for twenty years. He was Assistant Chief Negotiator for British Columbia on the Nisga’a Land Claim from 1992 to 1996 and a member of the Budget Process Review Panel in 1999. Mr. Gordon was elected a fellow of the Chartered Accountants of British Columbia in 1995. He is also a director of British Columbia Railway Company and a director of the Victoria Foundation.

Mary MacGregor
Mary MacGregor is a Kamloops lawyer. She was born and raised in British Columbia, and has agriculture and law degrees from the University of British Columbia. She has a lifetime involvement with the people of the beef cattle industry. For the past 25 years she has volunteered her time to work on policy issues with local, regional, provincial and national cattle producers’ organizations including several terms as director on the boards of the B.C. Cattlemen’s Association and Canadian Cattlemen’s Association. She has been a member of the Fraser Basin Management Board and the British Columbia Farm Debt Review Board, and continues to participate on the Vancouver Foundation Environmental Advisory Committee and the Canadian Bar Association B.C. Branch Provincial Judicial Advisory Committee.

Stephen Thomson
Stephen Thomson is President of Thomson Agri-Consulting Services Ltd. and Executive Director of the British Columbia Agriculture Council. He has worked with the British Columbia agricultural industry in various capacities since 1974 when he received his Bachelor of Science and Geography from the University of Victoria. Mr. Thomson is also a Director of the Kelowna Museum, an executive member of the B.C. Chamber of Commerce, a member of the B.C. Business Task Force on Regulatory Impact and was formerly President of the Kelowna Chamber of Commerce.
APPENDIX C – PRESENTATIONS AND SUBMISSIONS

Ministries and Agencies

Auditor General of British Columbia
British Columbia Assets and Land Corporation
British Columbia Buildings Corporation
British Columbia Ferry Corporation
British Columbia Hydro and Power Authority
British Columbia Lottery Corporation
British Columbia Railway Company
British Columbia Transit
British Columbia Transportation Financing Authority
Forest Renewal British Columbia
Insurance Corporation of British Columbia
Ministry of Aboriginal Affairs
Ministry of Advanced Education, Training and Technology
Ministry of Children and Families
Ministry of Education
Ministry of Employment and Investment
Ministry of Energy and Mines
Ministry of Finance – Capital Division, Office of the Comptroller General,
Public Sector Employers’ Council, Treasury Board Staff
Ministry of Forests
Ministry of Health
Ministry of Social Development and Economic Security
Ministry of the Attorney General
Ministry of Transportation and Highways
Rapid Transit Project 2000 Ltd.
### Public Submissions

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Affiliation</th>
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<tbody>
<tr>
<td>Ralph Allan</td>
<td></td>
<td>Private individual</td>
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<tr>
<td>Neil Batho</td>
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<tr>
<td>Neil B. Cook</td>
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<td>Private individual</td>
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<td>D.B. Doerksen</td>
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<td>Ron Hutchison</td>
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<td>Dave Jaffe</td>
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<td>Fred Kirkman</td>
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<td>Private individual</td>
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<tr>
<td>Ken McLennan</td>
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<td>Private individual</td>
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<tr>
<td>Jack &amp; Irene Record</td>
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<td>Private individuals</td>
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<tr>
<td>Stan Shepherd</td>
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<td>Private individual</td>
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<tr>
<td>Terence M. Taylor</td>
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<td>Private individual</td>
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<tr>
<td>Norma Strachan</td>
<td>Executive Director</td>
<td>ASPECT - B.C.’s Community Based Trainers</td>
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<tr>
<td>George Morfitt</td>
<td>Acting President and CEO</td>
<td>BC Automobile Dealers Association</td>
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<tr>
<td>Andrew Wynn–Williams</td>
<td>Director, Policy Development and Communications</td>
<td>BC Chamber of Commerce</td>
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<tr>
<td>Phillip Legg</td>
<td>Director of Policy Development</td>
<td>BC Federation of Labour</td>
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<tr>
<td>George Heyman</td>
<td>President</td>
<td>BC Government and Service Employees Union</td>
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<td>Jerry Lampert</td>
<td>President and CEO</td>
<td>Business Council of BC</td>
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<tr>
<td>Seth Klien</td>
<td>BC Director</td>
<td>Canadian Centre for Policy Alternatives</td>
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<td>Brian Kieran</td>
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<td>Certified General Accountants Association of BC</td>
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<tr>
<td>Colin W. Bennett, CMA</td>
<td>Executive Vice President &amp; Chief Staff Officer</td>
<td>Certified Management Accountants Society of BC</td>
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<tr>
<td>Chuck Chandler, FCA CBV</td>
<td>President</td>
<td>Chartered Accountants of BC</td>
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<td>Gary Jackson</td>
<td>President</td>
<td>Royal Diamond Casinos Inc.</td>
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<tr>
<td>Lindsay Olson</td>
<td>Vice President, Pacific Region</td>
<td>Insurance Bureau of Canada</td>
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<tr>
<td>D.S. (Don) Andrews</td>
<td>President</td>
<td>lead-manage.com Consulting Inc.</td>
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<tr>
<td>Lorne M. Grasley</td>
<td>Director, Policy, Research &amp; Finance</td>
<td>Mining Association of BC</td>
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<tr>
<td>Martha C. Piper</td>
<td>President and Vice-Chancellor</td>
<td>The University of British Columbia</td>
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The following are highlights of some of the views expressed in the submissions. Note – the following are not the views of the Panel:

- the economic outlook for 2001 has weakened since the March budget forecast and should be revised downward although economic growth is still expected;
- the uncertainty surrounding Aboriginal land claims is a significant economic issue that needs to be resolved to enhance economic growth and fiscal capacity;
- energy prices are volatile and unlikely to be as high as forecast in the March budget for 2002 and 2003, and forest revenue projections in the budget may be optimistic;
- the province needs a fiscal plan or strategic plan to achieve a balanced budget and manage debt through the course of fundamental change;
- financial results for the SUCH sector should be consolidated into the Summary Accounts and, in general, Generally Accepted Accounting Principles should be enshrined in government accounting policy;
- BC’s economic performance has lagged. Policy changes that enhance competitiveness are needed, including changes to taxation, regulatory reform and land use planning processes;
- government needs to focus on objectives and measurable results to improve efficiency, service and accountability;
- taxation and expenditure are unsustainable, requiring smarter spending and policy changes to create a strong economy that can support crucial services like health and education;
- tax cuts erode British Columbia’s fiscal capacity;
- the announcement of the tax cut before completion of the fiscal review calls the value of the review into question;
- government provides many important services and benefits including protecting health, safety and the environment through regulation, and providing services such as healthcare, education and infrastructure, all of which have social and economic benefits. It is important that benefits be maintained and not reduced in the name of reducing spending or increasing government efficiency;
- the Panel should not inflate the deficit to create an unnecessarily pessimistic forecast so as to show a structural deficit and induce dramatic spending and service cuts – there are choices;
- structural change in government should be developed and implemented using a partnership model, not a unilateral and confrontational approach;
- deferred maintenance may be limiting the ability of physical infrastructure to deliver services in some parts of the public sector including post-secondary education;
- ICBC should be subject to a full actuarial review;
- there is scope for increased government revenue and economic growth by changing current gaming policy; and
- there is a need to account better for government’s overhead costs to control their growth.
APPENDIX D – SUMMARY ACCOUNTS
REPORTING ENTITY 2000/01

TAXPAYER–SUPPORTED CROWN CORPORATIONS AND AGENCIES
(GOVERNMENT ORGANIZATIONS)
RECORDED ON A CONSOLIDATED BASIS

Consolidated Revenue Fund

Health Sector
B.C. Health Care Risk Management Society
British Columbia Health Research Foundation
Canadian Blood Services
Forensic Psychiatric Services Commission
Health Facilities Association of British Columbia

Education Sector
Industry Training and Apprenticeship Commission
Private Post–Secondary Education Commission

Natural Resources and Economic Development Sector
552513 British Columbia Ltd
577315 British Columbia Ltd
580440 B.C. Ltd
BC Immigrant Investment Fund Ltd
B.C. Games Society
B.C. Pavilion Corporation
B.C. Society for the Distribution of Gaming Revenue to Charities
British Columbia Assets and Land Corporation
British Columbia Enterprise Corporation
British Columbia Securities Commission
British Columbia Trade Development Corporation
Columbia Basin Trust
Creston Valley Wildlife Management Authority Trust Fund
Discovery Enterprises Inc
Duke Point Development Limited
Fisheries Renewal BC
Forest Renewal BC
Homeowner Protection Office
Okanagan Valley Tree Fruit Authority
Oil and Gas Commission
Pacific National Exhibition
Science Council of British Columbia
Tourism British Columbia
Vancouver Trade and Convention Centre Authority

July 23, 2001
Transportation Sector
BC Transportation Financing Authority
British Columbia Ferry Corporation
British Columbia Transit
Rapid Transit Project 2000 Ltd
Victoria Line Ltd

Social Services Sector
B.C. Community Financial Services Corporation
British Columbia Housing Management Commission
Provincial Rental Housing Corporation

Other Sector
B.C. Festival of the Arts Society
British Columbia Arts Council
British Columbia Assessment Authority
British Columbia Buildings Corporation
British Columbia Heritage Trust
British Columbia Systems Corporation
First Peoples’ Heritage, Language and Culture Council
Legal Services Society
Organized Crime Agency of British Columbia Society

Self-Supported Crown Corporations and Agencies
(Government Enterprises)
Recorded on a Modified Equity Basis

BCIF Management Ltd
British Columbia Hydro and Power Authority
British Columbia Liquor Distribution Branch
British Columbia Lottery Corporation
British Columbia Railway Company
Columbia Power Corporation
Insurance Corporation of British Columbia
Provincial Capital Commission

1This organization reflects a government partnership amongst Canadian provinces and is proportionally consolidated based upon the province’s share (14.9%) of the total provincial contributions to the partnership.
2This company owns shares in Skeena Cellulose Inc and was previously recorded on a modified equity basis.
3This company has sold its investments and no longer has any financial interest in Western Star Trucks Holdings Ltd.
4This company provides funding to the Vancouver Trade and Convention Centre Authority that, in turn, constructs the Vancouver Trade and Convention Centre.
5This organization was established during the current year.
6British Columbia Systems Corporation ceased operations on April 30, 2000. All assets have been transferred to the province.