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REPORT OF PROCEEDINGS
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SELECT STANDING COMMITTEE ON

PUBLIC ACCOUNTS

Victoria

Friday, November 25, 2011

Issue No. 20

BRUCE RALSTON, MLA, CHAIR

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**SELECT STANDING COMMITTEE ON
PUBLIC ACCOUNTS**

Victoria
Friday, November 25, 2011

- Chair:* * Bruce Ralston (Surrey-Whalley NDP)
- Deputy Chair:* * Douglas Horne (Coquitlam-Burke Mountain BC Liberal)
- Members:*
- * Randy Hawes (Abbotsford-Mission BC Liberal)
 - * John Les (Chilliwack BC Liberal)
 - * Joan McIntyre (West Vancouver-Sea to Sky BC Liberal)
 - * John Rustad (Nechako Lakes BC Liberal)
 - * Ralph Sultan (West Vancouver-Capilano BC Liberal)
 - * John van Dongen (Abbotsford South BC Liberal)
 - * John Yap (Richmond-Steveston BC Liberal)
 - * Spencer Chandra Herbert (Vancouver-West End NDP)
 - * Kathy Corrigan (Burnaby-Deer Lake NDP)
 - * Guy Gentner (Delta North NDP)
 - * Lana Popham (Saanich South NDP)
 - Shane Simpson (Vancouver-Hastings NDP)
 - * Vicki Huntington (Delta South Ind.)
- * denotes member present*
- Other MLAs:* John Horgan (Juan de Fuca NDP)
- Clerks:* Kate Ryan-Lloyd
Susan Sourial
- Committee Staff:* Josie Schofield (Manager, Committee Research Services)
-

- Witnesses:*
- Peter Bourne (Office of the Auditor General)
 - John Doyle (Auditor General)
 - Bill Gilhooly (Office of the Auditor General)
 - Michael Macdonell (Office of the Auditor General)
 - Les MacLaren (Ministry of Energy and Mines)
 - Stuart Newton (Comptroller General)
 - Charles Reid (CFO, B.C. Hydro)
 - Kenneth Ryan-Lloyd (Office of the Auditor General)
 - Raj Sihota (Office of the Comptroller General)
 - Cheryl Yaremko (B.C. Hydro)

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MINUTES

SELECT STANDING COMMITTEE ON PUBLIC ACCOUNTS



Friday, November 25, 2011

8:00 a.m.

Douglas Fir Committee Room
Parliament Buildings, Victoria, B.C.

Present: Bruce Ralston, MLA (Chair); Douglas Horne, MLA (Deputy Chair); Spencer Chandra Herbert, MLA; Kathy Corrigan, MLA; Guy Gentner, MLA; Randy Hawes, MLA; Vicki Huntington, MLA; John Les, MLA; Joan McIntyre, MLA; Lana Popham, MLA; John Rustad, MLA; Ralph Sultan, MLA; John van Dongen, MLA; John Yap, MLA.

Unavoidably Absent: Shane Simpson, MLA

Others Present: John Doyle, Auditor General
Stuart Newton, Comptroller-General

1. The Chair called the Committee to order at 10:02 a.m.
2. The following witnesses appeared before the Committee and answered questions relating to the Auditor General's Report: *Observations on Financial Reporting: Summary Financial Statements 2010/2011* (September 2011)

Witnesses:

Office of the Auditor General:

- John Doyle, Auditor General
- Bill Gilhooly, Assistant Auditor General
- Peter Bourne, Executive Director

Government:

- Stuart Newton, Comptroller-General
- Raj Sihota, Manager, Summary Financial Statements, Financial Reporting & Advisory Services, Office of the Comptroller General

3. The Committee recessed from 12 noon to 12:14 a.m.
4. The Committee recessed from 12:51 p.m. to 12:57 p.m.
5. The following witnesses appeared before the Committee and answered questions relating to the Auditor General's Report: *BC Hydro: The Effects of Rate Regulated Accounting* (October 2011)

Witnesses:

Office of the Auditor General:

- John Doyle, Auditor General
- Michael Macdonell, Assistant Auditor General
- Kenneth Ryan-Lloyd, Manager

Government:

- Les MacLaren, Assistant Deputy Minister, Energy and Mines
- Charles Reid, Executive Vice President, Finance and Chief Financial Officer, BC Hydro
- Cheryl Yaremko, Chief Accounting Officer, BC Hydro.

6. The Chair updated the Committee on the in-camera session held on November 16, 2011.

7. The Committee adjourned to the call of the Chair at 2:52 p.m.

Bruce Ralston, MLA
Chair

Kate Ryan-Lloyd
Deputy Clerk and
Clerk of Committees

FRIDAY, NOVEMBER 25, 2011

The committee met at 10:02 a.m.

[B. Ralston in the chair.]

B. Ralston (Chair): We have an agenda before us which we'll deal with in the course of the time that we have. The scheduled time of the end of the meeting is 3:30 p.m. I'm optimistic that we may finish before that. I know there are some members who have other obligations that they'd like to get to, but that time is available, should we absolutely need it.

The first item on the agenda, then, assuming that there are no objections to the agenda....

G. Gentner: Just a point of clarity. We have two major reports coming here today, and both reference Hydro. Relative to the *Observations on Financial Reporting*, which is an overlap of some of the comments and suggestions from the Hydro report, are we going to try and remove that discussion within the *Observations on Financial Reporting* of Hydro to the other, second item, or are we going to merge, blend it all together?

B. Ralston (Chair): Thank you for raising that. What I was going to say — you've anticipated my comment on this — was that we deal with the issue of rate-regulated accounting in the second report, the B.C. Hydro report. In the first report there are some comments on it, obviously, so I'd prefer that we deal with it together in the B.C. Hydro report. That's obviously the most significant government enterprise that uses rate-regulated accounting. If that's satisfactory....

With that, if we could turn to item 1, which is the report of the Auditor General on *Observations on Financial Reporting: Summary Financial Statements 2010-11*. If I could just ask the Auditor General to introduce his group and Mr. Newton to introduce his, and then we'll begin.

J. Doyle: Chair, I have with me today Bill Gilhooly, assistant Auditor General, responsible for the financial audit. On my left I have Peter Bourne, who's an executive director and was responsible for this particular report.

S. Newton: I have with me Raj Sihota. He's the manager of summary financial statements, from our financial reporting and advisory services area. I also have a few staff in the gallery, as well, in case we need to ask further questions.

B. Ralston (Chair): Thanks very much. I'll turn it over to you, Mr. Doyle, and away we go.

**Auditor General Report:
Observations on Financial Reporting:
Summary Financial Statements 2010-11**

J. Doyle: Good morning, Members. Government issued its summary financial statements a bit later than usual this year, on July 18, 2011. The audit was again very challenging. In addition to the usual pressures with such a large undertaking, there continued to be a number of significant issues. Most were resolved satisfactorily after discussion with government, although an application to the court was needed to obtain information I required to finish my audit.

However, there is still one reservation to my audit opinion, one of three that were included in the report last year. As I've mentioned before, whilst this reservation continues to be of great concern to me since it is a departure from Canadian GAAP, government could easily resolve it.

[1005]

Also of concern to me are upcoming financial reporting issues such as the conversion to new accounting standards by virtually all government entities — either from private sector or not-for-profit standards to those of the Public Sector Accounting Board. Next year there'll be movements of the trading organizations to international financial reporting standards.

Government has provided itself, through an amendment to the Budget Transparency and Accountability Act, the ability to choose from accounting polities that are outside of Canadian GAAP. The main issue so far revolves around the rate-regulated accounting, which we will discuss later.

In July government passed a regulation that says that B.C. Hydro will use part of a U.S. accounting standard that allows the continued use of rate regulation from the April 1, 2012. However, rate-regulated accounting will not be permitted in the Canadian GAAP from that date onwards, as things stand at the moment.

The Ontario government recently legislated how public entities must record capital contributions from government, which appears contrary to Canadian GAAP. I have been told that the B.C. government is considering the same move. Ontario has also legislated that Hydro One, their equivalent to B.C. Hydro, should prepare its financial statements using U.S. accounting standards rather than Canadian GAAP. So there's a lot of fluctuation and uncertainty as we go forward in this particular area.

It's a very significant concern when governments turn their backs on accounting policy set by independent standards-setters — Canadian ones — and opt, instead, to legislate their own results. In my view, users of financial reporting are not well served by this.

B.C. was considered a leader across Canada when it implemented its financial reporting to be fully in accordance with Canadian GAAP. I see the recent and pending

changes that have been made as a step backwards in this regard and may be the start of future departures from GAAP. I hope the B.C. government will strive to resolve these issues and others in this report before they become more significant.

I follow the same process that I followed in most of my audits. I advise in the background. I then talk about more formally that I actually report out on the issues that I find. And I've been through those stages in regards to these issues.

I will now ask Bill to handle the technology and Peter to make a short presentation on the observations report.

P. Bourne: Good morning, Members. Our report on the summary financial statements is broken down into the five areas on the screen. I'll briefly expand on each of these areas, starting with the five key issues of the report.

The five issues that we felt were the most important in the report are listed on the screen. These five key issues are discussed in detail, beginning on page 10 of the report. I'll briefly discuss each of these issues over the next five slides.

No. 1 on the list of key issues is the one reservation that was included in the audit opinion on the fiscal 2011 summary financial statements. The Transportation Investment Corporation was consolidated using the modified equity method rather than being consolidated on a full line-by-line consolidation method. This is a significant departure from Canadian generally accepted accounting principles.

On page 11 of the report the bullets on the right-hand side show the changes to the summary financial statements that would have been made had the item been corrected. This issue has resulted in an audit reservation for the last three years. It should be noted that it would not have been difficult for the government to correct this error and receive a clean audit opinion.

No. 2 on the list of key issues is the two reservations that were removed from this year's summary financial statements audit opinion, and these are discussed on page 12 of the report. I would like to point out that government has not corrected these errors since last year. They are not included in the audit opinion reservations simply because the dollar amount of the error has decreased this year. If the size of the error increases and government does not change its accounting policy, then this could again result in audit opinion reservations in future years.

The third key issue is the changes that will result in government reporting due to changing accounting standards. This is, as John mentioned, a significant change that is driven by Canadian standards-setters and will require a lot of resources on the part of government, private sector auditors and our office in order to implement the changes properly. Government provided some direction to the individual Crown corporations and other entities

that make up the government's summary financial statements as to what standards they will implement.

[1010]

Government business enterprises will implement international financial reporting standards beginning in 2011, except for B.C. Hydro. Other government organizations have been directed to use public sector accounting standards beginning in 2011, while schools, universities, colleges and hospitals have been asked to implement public sector standards starting in 2012.

Item 4 is rate-regulated accounting. Then, obviously, there is still an outstanding issue with respect to government's use of rate-regulated accounting. Rate-regulated accounting allows government to defer revenues and expenses. For example, at March 31, 2011, B.C. Hydro had almost \$2.2 billion in deferred expenses in its financial statements.

If rate-regulated accounting were not permitted by standards-setters, then B.C. Hydro in the summary financial statements would have to expense rather than defer a large amount of costs. Had rate-regulated accounting not been allowed in fiscal 2011, then expenses would have increased in B.C. Hydro and in the summary financial statements by about \$450 million.

Canadian standards-setters have allowed the use of rate-regulated accounting to continue for one additional year. Therefore, B.C. Hydro will be able to use rate-regulated accounting until March 31, 2012.

If rate-regulated accounting is not allowed in Canada, then government has provided itself, through changes in the Budget Transparency and Accountability Act, with the legal ability to choose an accounting policy, or a part thereof, that is different than Canadian generally accepted accounting principles.

In fact, in July 2011 government amended a regulation to the BTAA. Based on the amended regulation, B.C. Hydro will implement U.S. accounting standard FAS 980 as of April 1, 2012. The government has not adopted the entire U.S. accounting standard. While in the U.S. the rate regulator is required to be independent, the B.C. government has omitted the requirement that the regulator be independent of government.

If government decides to apply accounting standards other than those endorsed in Canada, this could have an effect on the audit opinion that is provided on government's financial statements.

Similar to last year, included in the report is an analysis of internal control findings that have been discussed with the management and boards of various government entities during the fiscal year. This item starts on page 18 of the report. Again, we found that a large number of the issues were ones that had not been resolved from the prior year.

Also discussed in the report are five issues with eight recommendations, and the write-ups for these issues start on page 25. The issues include classification of debt,

disclosure of gaming grants, accounting for tax appeals, disclosure of changes in budgets, and transparency and utility of contractual obligation disclosures.

Appendix B on page 42 also shows which of the previous summary financial statement recommendations have not been implemented by government.

The report also includes six issues of general interest, starting on page 29 of the report.

Finally, beginning on page 34 is some background material on the composition of the government reporting entity and how the summary finance statements are compiled and audited, including information on the use of materiality and unadjusted errors.

I'll now turn it back over to John.

J. Doyle: That concludes our presentation, Chair.

S. Newton: Thank you, Chair. Thank you, Members.

I want to thank the Auditor General and his staff for the report and all of the challenging questions we get as we go through completing the year-end audit. I think it's important that we discuss these issues. It enhances our understanding. As well, it also provides new information, where we do actually change things. And in some cases it helps us solidify our original position as well. So it's a good process to go through, and I truly believe, despite the differences, it's very valuable.

The Auditor General has a reservation this year. It's a result, in my mind, of a difference in professional judgment about how accounting principles should best be applied, to faithfully represent the underlying substance of the Transportation Investment Corporation.

Based on my professional judgment, analysis of the transactions and programs, and broad consultation with experts in government and our independent policy advisory committee, we were unable to agree with the position taken by the Auditor General on this issue. We will continue to work with the professional community, other jurisdictions and the Office of the Auditor General to address the issues he has raised within this report.

[1015]

As standards continue to evolve year after year — and they're evolving much more quickly right now — my office will continue to work with the government community, other jurisdictions and the Auditor General to ensure that the province's accounting adapts to those changes in a principle-based way that best serves the information needs of the users. We will continue to lead the development of best practices in public sector financial reporting.

I'll go through this briefly because we've covered this for a couple of years now. Basically, in our opinion, the TI Corp does not receive subsidies from the provincial government to maintain its operations, which is a key factor in determining whether something is a government business enterprise or not. The effect is to report

the net change of government's investment in the entity as a single line item, rather than assets, liabilities, revenues and expenses on a line-by-line basis.

The reason for doing this is to separate the self-supporting or commercial activities of the government-reporting entity from core operations of government that are funded by tax revenues. This way the public can clearly see whether the bridge is actually paying for itself over its service life.

Related to these two issues, one of the things that we did at the beginning of the year this year was to ensure that as we go through the year, the summary of unadjusted differences that we have is kept low. The Auditor General and I talked at the beginning of the year about the challenges in doing this, but I committed to making the adjustments as quickly as possibly as we went through year-end, in order to keep that total error volume down, and I think we did a pretty good job this year.

There are still some that we haven't adjusted at year-end. Part of that's a materiality issue, timing issue. There's always a trade-off between making adjustments and having a larger potential summary of unadjusted differences or meeting the timeline for the year-end audit. That's a bit of a challenge for us, but I think we worked a lot better this year to keep that number low. I think that is evidenced by not having as large a value of errors, to have these show up as significant items.

These two are differences of agreement in professional judgment. The position of the Auditor General represents a very different view from our longstanding accounting policies and also different from generally accepted practices followed by other jurisdictions. We tried to provide greater clarity in these two areas by adding the natural resource note No. 28 to our public accounts to ensure that the statement's users were fully informed about natural resource revenues and to provide, also, increased transparency. I'm not going to go into the detail between these two.

It's a longstanding practice of the B.C. government to define "debt" as taxpayer-supported — that debt which will be paid for by tax revenues — and "self-supported" as the debt that will be paid for by user fees charged by commercial Crown agencies — like goods and services. This basis of defining the nature of debt remains relevant because it provides a clear description to financial statement users of how much debt will be paid for through the future taxation as opposed to the debt that will be paid for through commercial activities of government and business enterprises.

Just something to add to that. Once we define accounting policies, we need to consistently apply them to ensure that financial statements from year to year are comparable and we can understand the changes. Accounting standards require the province to disclose the nature of debt, and the province has adopted and maintains the longstanding policy of describing the nature of its debt primarily as taxpayer-supported and self-supported.

The value of the warehouse debt principle is guaranteed by investments in money market instruments of the government of Canada or Canadian high-grade investment institutions. It's always been recognized that the investment returns on the warehouse debt will rarely fund the full interest payment on the debt, so the warehouse debt fully passes on the net carrying costs to the client organizations to whom the debt is allocated, and therefore, the warehouse debt program never incurs a loss.

The warehouse debt program is consistent with the definition of self-supported debt because as borrowing in advance of requirements, it's not funding by revenues received from taxpayers. It's funded by the investment returns and the client organizations to which the debt is allocated. Over the last two years we've not had warehouse debt on the financial statements at year-end as well.

[1020]

Next is the recommendation on gaming grants.

All expenses are disclosed by the sector describing the objective or purpose of the transferor rather than that of the recipient, which is the case in how we've treated these. It would not be appropriate to selectively attribute transfers to a specific program to the function representing the recipient's areas of activity or the use of funds. The objective or purpose of government through this program is to distribute the proceeds of gaming to charitable organizations in accordance with the legislation. Therefore, the transfers made for this purpose were correctly reported in the other sector, as defined by StatsCan.

Also, the Public Safety and Solicitor General's website does have a complete disclosure of all these grants: the city, the recipient, the sector, as well as the amount. So there is full information in detail on how these grants were allocated.

The next one relates to the recommendation on tax appeals.

It's not possible to determine whether there is sufficient probability that an appeal will be successful and, therefore, should be recorded as a contingent liability. The liability for tax appeals cannot be reasonably estimated until each has been reviewed by the appeals officer and approved by the executive director of the tax appeals and administrative services branch. The obligation is not triggered in the appeal process until the individual case has been reviewed to the point that it's determined that the tax was collected inappropriately. Making an accrual based on historical percentages presupposes the outcome of the appeal process, which in itself undermines the principles involved with appeals.

There is a normal quarterly process for reviewing appeals, to identify which may need to be accrued or not. At March 31 there were none.

This one relates to the Auditor General's recommendation around how, when government's planned estimates are not prepared on a basis consistent with that used to report the actual results, the planned results should be restated.

The Auditor General's report identified restatement of the prior year's comparative amounts — that would be the '10-11 comparative amounts in the 2011-12 estimates which were authorized on May 3, 2011, after the reporting date of March 31, 2011. These changes affect only the comparative amounts in the '11-12 estimates, and no change was made to the authority provided by the 2010-11 estimates. In the absence of a formal regulatory change to the 2010-11 estimates, it was not appropriate to adjust the estimates amounts included in the 2010-11 public accounts.

The last item is a recommendation relating to providing additional disclosure on contractual obligations. We've included an additional detailed schedule of contractual obligations available on the web, and a link is provided in the notes of the financial statements. Further detail is available in the financial statement notes of entities that entered into these agreements.

Interested parties would be better served by examining the detailed disclosure in the financial statements of the Crown agencies reporting some of these obligations. While more detailed information may be valuable to interested parties, the narrow context of financial statement disclosure may not provide the best vehicle for reporting detailed information.

These recommendations may be better addressed through open data, where the appropriate evaluation of costs and benefits can be made as part of a broader strategy, unconstrained by the specific requirements and objectives of general purpose financial statements.

Any questions?

J. Yap: In your last slide, Stuart, you talked about open data. Can you expand a little more about the open-data strategy?

S. Newton: Government currently has a strategy to look at providing more open data to the public. The request for more information on contractual obligations is well outside of the basic requirements that you would have for a contractual obligation note in your financial statement. It seems to be related to a need to provide more information in relation to contracts.

So the best forum or the best recommendation would be to recommend that government in its open-data strategy look at providing more information in relation to contracts. That would be the more appropriate venue to get at, I think, the detail that people are concerned about getting in relation to all of the numbers that are showing up in the contractual obligations note.

[1025]

J. Yap: When we get to the open-data strategy, what would be included?

S. Newton: Not my decision to make, but if we were going to go to more open data in contracts, it would be a list of contracts, contract details, contracts amounts

and, you know, payments or requirements in relation to those contracts. A user would be able to look at the contracts that government has and get a better sense of what sort of payments would be required going forward, as well as the details as far as what a good deliverable would be, whether the contract is meeting those deliverables and what the specific requirements would be.

J. Yap: Last question: what's your sense on the timing of when this will come into place? Sometime soon?

S. Newton: On the contract side, we are still working towards developing a good contract management database. I think that individually in ministries, we've got information. We want to create a way to have all that data linked in one system together to make it more easily obtainable. That still has a bit of work to go.

So from a complete systemwide perspective, I would say we're probably a year away from that. But as far as individual contracts going out and ministries being able to provide data, that's up to those ministries. I wouldn't say they would be blocked from doing that. It's just that the central view piece from a key financial system is the piece that I would be interested in working on and that we're working towards.

K. Corrigan: I sense a growing frustration from the Auditor General, in that this year the Auditor General has added a piece to this report in pointing out what the potential impacts can be on an organization — in this case the B.C. government — for not complying with GAAP. I quote from the report: "In British Columbia accountability for not complying with GAAP appears to have had little impact on government."

The Auditor General also points out that "an audit report with reservations can impact the operations of an entity by lowering the entity's credit rating or share price or increasing the interest rates the entity's lenders charge, which in turn increases the entity's cost of raising money."

I was interested to also read that public corporations.... If they are given an audit opinion with a reservation, the B.C. Securities Commission would normally place a cease-trade order against the corporation.

So I sense a real frustration with, year after year, government simply saying: "We don't care what your opinion is." I think the fact that the Auditor General has pointed out that at some point this could have an impact on the province's credit rating is an important one.

I'm going to ask just a couple of questions. Maybe I'll ask them both. I do have some further ones, but I'll wait till everybody else goes. Then we'll see if we have time — if that's all right. So I'll just ask them, and then maybe they can be answered.

I'm wondering if the Auditor General has looked at an overall summary of what the impact would have been

on the books of this province if the province had done the books, done the accounting, the way the Auditor General has recommended. I'm thinking of things like: what would the overall impact be if you included everything, like getting rid of the rate-regulated accounting and so on?

The second question that I have is for Mr. Newton. I'm sure it's in here, but just overall, who makes the decision in government about what the accounting standards are? Are these individual decisions that are being made, or is there a central body that is making the decisions about what accounting standards are being used in various cases?

So those are my two questions for now.

B. Ralston (Chair): We'll start with you, Mr. Doyle.

J. Doyle: The impact of the reservation is shown within the body of the qualification. So it details what numbers have to change in order to meet the line-by-line consolidation.

[1030]

In the background, which is not usually reported, there's also a list of unadjusted errors or differences, some of which are genuine differences of view and some of which are things that could be fixed but, for whatever reason, weren't fixed. So there are two different numbers there.

That figure this year was a lot lower than it had ever been in the past, and that, too, could be adjusted on the face of the financials but hasn't been. It's not material by definition, and therefore, it's a smaller amount in comparison to the qualification that we actually issued.

As far as rate regulating is concerned, it's allowed under the GAAP. Therefore, I wouldn't enter into any calculations as to what would happen if it was reversed out for the current year, because it's actually part of GAAP, and it's permitted by GAAP.

K. Corrigan: Okay.

S. Newton: But to answer your question in relation to who makes the decisions on accounting standards, accounting standards are Treasury Board's decision. Our office does the research, working with other jurisdictions. We get advice from our accounting advisory committee as well, and then we prepare a briefing and a recommendation to Treasury Board. But the authority to set government's policies is Treasury Board's.

S. Chandra Herbert: I guess I'm a little concerned here — well, more than a little concerned here. I see the words of the comptroller general, which suggest that the government is committed to maintaining a leadership role in public sector reporting.

Yet I look at the Auditor General's comments and the report that the Auditor General's office has put out, and

it certainly doesn't look that way. In fact, it looks like the government has decided to move away from being a leader and, instead, do whatever they need to do to make the books look good for the government but not necessarily so for the public.

I think some of the decisions that have been made make it more difficult for the public to understand how the government is choosing to use tax revenue and general revenues and how they deal with debt concerns. So I think the Auditor General's comment that he remains very concerned that government is choosing to override the independent standard-setting process is a good one.

Based on that and based on comments he makes on page 10, I believe, where he states, "If a public corporation were given an audit opinion with a reservation, the B.C. Securities Commission would normally place a cease-trade order against the corporation. The public corporation then runs the risk of being delisted by the stock exchange on which it is traded...."

I'm curious, as there is an audit opinion reservation on the B.C. government's books, whether the Auditor General could explain a little bit more what he means in that section around public corporations. I understand the B.C. government operates a little differently, but why would that become an issue with a public corporation? What are the concerns? I'm hoping the Auditor might be able to explain that a little bit — in more detail about that.

J. Doyle: What we're talking about are listed entities. Basically, there's a public accountability and a requirement for these entities to report faithfully in regard to their financial operations. The auditors are in place to check whether or not they agree and to issue an opinion on the financial statements of any entity. That's the same in government as it is in the private sector.

An auditor would come in and — with his own panel of experts, his own expertise and skills and so on — actually review and test the financial statements that have been presented to him or her and then would form a view as to whether or not those financial statements complied with the standards and a whole list of other things as well.

[1035]

In this particular case and this province for the last — I don't know — 15 years.... In more than ten of those years it has resulted in a qualified opinion. Now, some of that was to do with the SUCH sector, which was all changed in 2004, that sort of a time period, when the SUCH sector was integrated into the public accounts. Some of it has been in the last few years when I have actually issued opinions.

My reservation is about non-compliance with GAAP. The TIC does not trade, and there is no provision that I can see in the standards that is future-looking. The only provision in the standards is: if an entity, for some reason, makes a loss one year, what do you do? And the answer

is: you have a look and you put it into context to see whether or not it's just a temporary aberration.

Well, this is a startup. It meets some of the requirements under the four tests, but at the moment it hasn't sold a single thing. The government has provided money to the entity in the form of working capital, startup capital, and the rest is loan money that's being received for the building of a bridge. Building a bridge is not a commercial enterprise — yet.

I have looked at the model that I've been presented with, and I still have some questions around that model. And I'm looking forward to the time when it's made more open so that I can discuss those in a more open forum. At this stage my conclusion is that until the TIC, or the Port Mann bridge project, starts to receive toll money and demonstrates that in fact the quantum of that toll money is suitable and appropriate to support its operations, I can't conclude that it's a government trading enterprise.

Because of that, the way that debt is defined by government.... It's by an organization, and the organization at the moment is not a trading organization. Therefore, its debts can't be self-supporting; it has to be taxpayer-supported. But I actually believe that if the model is right, going forward, it will be self-supporting. So I made a suggestion to change the definition of how we classify debt, which was rejected, and I don't understand why.

A lot of issues in that, and it's dangerous to draw analogies too much with the private sector. The only reason that I raised it was because of the importance of a reservation and in the fact that, in some jurisdictions that I'm aware of, a reservation means that the minister has to stand up in the House and explain.

There was one other reservation in the body of the GRE. There might've been two, but there was certainly one that I recall. Again, that was cleared out when the organization was consolidated.

B. Ralston (Chair): Mr. Newton, did you want to respond?

S. Newton: Yeah. I think it's important to note that the net effect of either consolidating the Transportation Investment Corporation on a line-by-line or on an equity basis is zero on the bottom line and zero on the accumulated surplus.

When government was looking at how to account for the Transportation Investment Corporation, we did talk to two of the rating agencies at the time. Both rating agencies considered it to be self-supported debt as well. So from a credit-rating perspective, cost-of-interest perspective, we weren't concerned that it would have an effect as well.

And truly, if you look at the comment that I made in my slide earlier, government is not supporting this organization. There's an initial investment, and we are looking at the value of our investment as we go along. But there's not ongoing support.

S. Chandra Herbert: Just to follow up, I'm still trying to square, in my head, how being a leader in accounting practices and openness and accountability squares with the Auditor's concerns about the government overriding the independent standard-setting process. Would the comptroller be able to explain how that qualifies as being a leader in accounting practices?

S. Newton: Sure. I think it's important to note that when you're looking at how you're going to treat various transactions or entities in your financial statements, you need to look to the economic substance. Many jurisdictions have similar issues that we have in regards to how we want to treat specific transactions or specific items.

[1040]

B.C. is a leader in working with those jurisdictions, as far as coming to a common understanding of how we are going to treat various items in our financial statements.

Specific items are.... And I can't speak to what individual relationships various comptrollers have with their auditors in other jurisdictions. They are all slightly different, but I wouldn't say that a qualification on the financial statements leads to lack of leadership in a particular area. I would say, for some items, making the decision that our treatment actually represents the true economic substance.... And we know we've got to do a bit of work with standards-setters to move them along, maybe leadership as well, because we're looking at how we're going to move the standard to be more appropriate.

Rate-regulated is one of those items that is hotly debated. We've made a choice. We are active in the standards-setting environment as far as how we can move the standard to more adequately reflect the economic substance of the transaction. I would say that's leadership as well. I wouldn't put it down to: "Just one reservation means that you're no longer playing at that level."

J. Doyle: I agree that the province put itself in a leadership role some years ago when it enshrined in legislation that they would follow GAAP. Most other provinces don't have that in their legislation, and that's one of the differences when you make the comparators between the different provinces.

B.C. put itself in a place — and I wasn't around at the time, but maybe some of you were — which said: "We will follow Canadian GAAP." And what has happened, to my view — and it's a bit of an outsider's view — is that there has been a breakdown in the expectations between what governments want the standards to be and what the standards-setters have actually come up with. That came to a head a couple of years ago, and there was a major discussion. I've made this observation to the committee before.

Because of that major issue, there has been a lot of work to try and close the gap between the expectations of senior governments and the standards-setters and

why they're separated. This is an outcome from that, I believe. There are some issues that senior governments feel strongly about, but the standards-setters are in a different place, for whatever reason.

My legislation is quite clear — crystal-clear: GAAP. Therefore, I do the audit in accordance with GAAP, and I conduct the audit in accordance with the auditing standards. That's enshrined in my legislation, and the assembly gave it to me. So whilst I understand the difficulties that may be there, the reality is that it's not about economic substance. It's about what the rules say about reporting.

You see, I happen to agree with the comptroller general that I would assess, and so would the rating agencies, that the debt will eventually be self-supporting. But in accordance with the definition put out by government and the current standards in regard to what a trading organization is, it puts the debt into taxpayer-supported, which I think is nonsense — hence, the recommendation that I made that was rejected, which I don't understand.

The issue here is that there are.... Financial reporting needs to be faithful to the framework that's been established and put forward. And the legislation says it has to be done. If that's uncomfortable, then there needs to be work done to change the standards through the standards-setting process, or there needs to be some relaxation — and I don't think this is a good move — through the legislation to avoid actually following the standards as they are written at the moment.

I think that's the problem. I think Canada at the moment is, in some respects, poorly served by the quality of some of the accounting standards that cover financial reporting.

G. Gentner: I think, for me, we're getting somewhere here. And thanks, Kathy, for your question. I want to continue along the line where Spencer is coming from. On page 6, relative to leadership, of course the Auditor General refers to a need to consult before any major events occur.

[1045]

Back on page 5 he's referencing the very concern that the government is choosing to override the independent standards-setting process, as discussed, and how, of course, the Budget Transparency and Accountability Act was amended. It does seem that the government has used legislative power to redefine accounting standards to accommodate its own needs.

Now, on page 8, March 10, government anticipated a \$1.7 billion deficit. Instead, we had a deficit of about only \$300 million. Even when government presented its third-quarter update — and I'm referring, of course, to the report — on February 15, 2011, the year-end deficit of \$1.3 billion was still projected. However, it was a \$1 billion improvement in just three months.

Can the government explain this? I mean, how could the government justify this? I think the Auditor General

is asking how these improvements came about so quickly. There was no information provided. Or is it basically creative projections over estimating deficits? You know how you do. You make some things look gloomier than they really are, and suddenly miracles occur.

Just referencing a renowned economist, Erik Andersen, who is economist for Transport Canada, airports branch, and various corporations. He basically called this kind of fixing.... Actually, I'll paraphrase it, because I don't think the words are too acceptable. We'll call it serial fibbing, if you will, and "a practice regular institutions would have been fined and/or have gone to jail for. In your personal life, you would not tolerate receiving financial statements that are either deliberately incomplete or deliberately misleading."

Could the Auditor General explain...?

B. Ralston (Chair): Member, I just want to call you to order. The words "deliberately misleading" are unparliamentary.

G. Gentner: I withdraw the quote from Mr. Andersen, therefore.

B. Ralston (Chair): Thank you.

G. Gentner: But in particular, can the government explain this discrepancy, if you will, between this \$1.7 billion deficit suddenly changed to \$300 million? And again, within a few months, we went to \$1.3 billion. Maybe the Auditor General can explain how well the government was able to provide these sorts of improvements in such a short time.

B. Ralston (Chair): Who wants to be first?

J. Doyle: I'll go first. I have no idea.

S. Newton: All I can answer is what the financial statements were at the end of the year. I'm not going to go into detail as to what government was doing as far as how it reported out on Q3. There was a presentation made at the year-end by the minister that described the changes that occurred. There is one item in the financial disclosure and analysis that talks about the balance changes. But when you're talking about summary financial statements, in accountant-speak we're going to say the number was expected to be this. It is now this. There's some minor detail that talks about the differences in various sectors.

That's about it at the financial statement level. Those would be better questions asked of the minister.

J. Doyle: I'll just make an observation for the benefit of the members. At the beginning of the *Public Accounts* document, there is a section which explains the major

aspects and impacts of what's occurred. Some of it is forward-looking and looks at economic issues, and some of it is about the financials themselves.

One of the observations I made was that there was nothing in there which actually explained — not the \$1 billion; I didn't raise that issue at the time — how it was that such a large projection was reduced from a \$1.7 billion deficit, I think, and how \$1.4 billion was clawed back.

I expected to see a lot of information in that front end for users to see how well.... You know, it was a great result — \$1.4 billion less. And I thought there would be an explanation for it, but I didn't find it, and it's a gap that's there.

[1050]

Now, we don't normally audit that particular section of the public accounts, but we do look at it to make sure that it's not in conflict with anywhere else in the financial statements. Therefore, it wasn't raised in any of our documentation, because we don't conduct an audit, actually, on it. But it is there in the document, and you won't find any major explanation in regard to why \$1.4 billion was clawed back.

B. Ralston (Chair): Mr. Newton, did you have anything further, then, since there seems to be an exchange here?

S. Newton: Just that the analysis is from budget-to-actual over the course of a full year. This was a difference of Q3 to Q4. So that's not usually not contained in this as well.

Typically, with the FSD-and-A, financial statement discussion and analysis, we're looking at broader indicators over a larger number of years. We got five-year indicator information. But it's usually at this number change, this amount, to be able to allow for financial statement analysis, not a full and complete description of all the choices that were made by government in moving through the year in relation to budget-to-actual financial information. It is really more at the numbers level.

B. Ralston (Chair): So your view is that it's a question more properly addressed to the political level, then.

S. Newton: Yes.

V. Huntington: Spencer and Kathy canvassed my primary question, so I just have two, three short ones that have risen out of the discussion. I'm assuming Treasury Board is merely human, unlike comptrollers and auditors general. So I have to assume that it is your office, Mr. Newton, that is providing advice and recommendation to Treasury Board in the area of accounting standards. Is that so?

S. Newton: That is correct, yes.

V. Huntington: So basically, Treasury Board is reacting to your advice on what the standards ought to be, generally?

S. Newton: They take the information that we provide. We provide a significant amount of background on where other jurisdictions are at, where accounting standards are going, where we believe the best treatment is. Then based on all that information, in their judgment and deliberation, they make a decision, yes.

V. Huntington: Thank you. You referred to an independent advisory committee. Who is on that committee, and what is their relationship to your office?

S. Newton: There is Accounting Policy Advisory Committee. It's made up of members in industry, so professional accountants of a variety of different designations. Some are involved in the standards-setting process as well. They meet quarterly, and they provide advice to Treasury Board on accounting policies.

We meet with them to discuss the audit report — the findings in the audit report, our choices. We look to them to provide information back to us and back to Treasury Board on what they think about the choices that we have made as well as to get advice on choices or changes that we are considering.

V. Huntington: Do you feel there's additional value in discussing those things or taking their advice as opposed to working with the Auditor General — that the advice is that different?

S. Newton: We get advice from a variety of groups. There's the Accounting Policy Advisory Committee, the work we do with the Auditor General's office. There is a council of comptrollers across Canada. We meet face to face annually, but we also are in contact through a variety of web links to discuss issues. There are, I think as frequently as monthly, teleconferences with the other jurisdictions on the standards-setting issues and on the accounting policy issues that we are dealing with on a regular basis, to get input from them as well.

V. Huntington: Can we find the names and companies of the members of this committee?

S. Newton: I'm not sure. I don't know if that's available or not. I'll check to make sure.

V. Huntington: It should be, I would think, somewhere, or if we could have it, that would be good.

One other really quick one. You mentioned that you were looking at ways in which to publish the detail of the contracts. Normally, if you ask for financial detail of contracts, especially in the P3 category, it would be re-

acted. Do you think that P3s will be included in these data banks that you're trying to prepare?

[1055]

S. Newton: From my perspective, we are looking to create a database that has all contract information, all contracts in it. Now, we're looking at it from a completeness of contract information. It would be ministry by ministry as far as what would be releasable. They're still subject to freedom-of-information requirements as far as any of the requirements. That act would require them to not release specific information. Until I get specifics, I can't tell you which pieces.

V. Huntington: So there's no specific government policy about how, what and when to release. It's up to each ministry to determine.

S. Newton: No. Ownership of financial information is at the ministry level. Government is working on a strategy for open data and looking at what can be released. I'm not up on the specifics in the open data strategy. I only know my little piece. I'm looking for a way to get a complete view of contracted information.

Providing contracts publicly — other jurisdictions are doing it. I believe that would be an assumption — that the province would be doing that as well. I do know that the province is releasing more contract information than it has in the past. As far as the completeness and release of individual contracts, I think that remains to be seen. I don't have information on specifically when that is going to occur.

V. Huntington: Thank you very much. Just one final comment. I find the report unhuman, very dense, very important. It would, I think, be really nice to see the Auditor General and the comptroller general get closer on some of these issues and resolve them, because they are disturbing to read. I would think members opposite would find that too, to a large degree. There shouldn't be this difficulty in obtaining Canadian GAAP standards, I don't think. It would be nice to see some of these issues resolved at some point.

B. Ralston (Chair): Maybe they'll take advantage of the holiday season.

J. McIntyre: I think it's an interesting observation, though, that the Auditor General, in a comment, I guess, a couple of moments ago had said that there are issues, it would appear, across the country. He was talking about senior governments — plural. It's not particular to this. I think it's fair to say that there are obviously some issues, and these standards....

I've been on Public Accounts for five or six years now, and it's clear that these standards are changing. All of

a sudden we were doing GAAP, and now it's the international standards. Standards are set. We encounter different situations and different things in accounting all the time, it would appear.

I am no expert, but I think that, certainly in my time, it seems there has always been some rub and some tension between how these things are settled. Like anything, it's professional judgment. We don't always agree. I think we have to respect the different perspectives. That said, we obviously want to be seeing that we can move closer.

I had a particular question about the recommendation, Auditor General, on the gaming grants. That seemed a new and different twist in this year's go-round. I thought that on the surface it might sound logical, but in addition to some of the reasons that the comptroller general gave for not moving this way, I was just reflecting that that would seem to sort of wreak havoc on any kind of ministry estimates. Maybe at the beginning of the year you have your estimates for your expenditures. At the end of the year you would have grants that you didn't anticipate, necessarily, being accorded in your sector.

That would affect all sorts of things. It would affect your ability to balance your own ministerial budget. There's holdback for ministers that don't meet their budget. I know that the gaming grants come out in quarters of the year. I don't understand how that would be reasonable for a ministry at the beginning of a year to prepare their estimates and their service plan and then have a slew of grants go.

There are thousands of grants. Somebody would have to be, presumably, saying: "Now, does this fall under Social Development, or is it a little bit of preventative health, or is it MCFD?" I just can't see the logistics of any of this sort of working. As we know, we're undergoing a review right now that's in the minister's hands. We're expecting that the whole process may be revamped.

Anyway, I was just very curious about why you would come up with this recommendation suddenly.

[1100]

J. Doyle: The whole purpose of financial reporting is to record what happened. If you look at the press releases for these grants, it's quite clear — the purpose they're going to be used for. You can go and have a look at them. Yet the bookkeeping says something different. This doesn't affect the ministerial holdback; it doesn't affect the budget that goes to a ministry; it doesn't affect the balanced budget.

What this is about is: what was the purpose of the grant? And if it was spent on this particular purpose, don't record it as if it was spent on a different purpose. Really, it's about faithfulness in the presentation of information. If X amount goes to.... I'm not going to mention topics, because, you know.... If it goes to X, then that's the amount of money that's gone to X, and that's a decision that's been made, to send that money

to X from this particular source. Then that's what the books should show: that it's gone to X. So that's what it should be reported as, not that it's gone to Y.

It popped up because a number of the auditors were actually conducting some additional work on the grants that were being made. You may recall that there was some media coverage last year about how government had not paid out huge sums of money from this particular pool of funds to charities. We did some work on that because we couldn't believe the numbers that were being called out. In fact, we found out that the figure, instead of a billion dollars or whatever the figure was, was really quite small, almost negligible.

Whilst we were in the neighbourhood and we were looking at, "Well, how does this all work?" as far as the bookkeeping is concerned, we realized that there was this disconnect between the stated purpose of the grant and the way it was actually being recorded at the moment.

All we've said is, for financial reporting purposes — nothing to do with budgets or anything else — just record the substance of the transaction, which is that it's going to this particular activity. We thought that was the simple, straightforward recommendation, quite frankly, and we don't understand why we haven't got an immediate: "Yes, that's a good idea."

B. Ralston (Chair): Mr. Newton may want to comment.

J. McIntyre: Yeah. I still don't understand why they don't affect each other. I guess maybe it's because I'm not an accountant. But I'm not sure that I fully understood. I would like to hear from the comptroller.

B. Ralston (Chair): There's no need to apologize.

J. McIntyre: Thanks, Bruce.

S. Newton: When you're looking at the expenditures under the gaming grant, they are for charitable purposes, and they are not specific for this percent for that purpose, this percent for that purpose. In order to record it appropriately in the sector that's making the expenditure.... These are for gaming grants for charitable purposes. Under the StatsCan sector rules.... I'm not an expert as far as why it would go in "other;" I know that it goes in "other."

The purpose for which the grant is being given determines where it lives. So if it's for charitable purposes, gaming grants go into "other." It's not specific as to what the grant is going to be for in the legislation. We're following the primacy of the legislation that says that these are for charitable purposes, and that sets the category that they go in.

J. McIntyre: If I could ask a follow-up. Are you saying that thousands of grants would be line items in the

Environment budget or the Health budget or the Social Development budget? I'm sorry, I just still don't understand it all.

J. Doyle: Well, that's because I never addressed the issue of budgets.

When government makes a payment, there is some basic bookkeeping that is being done, which is credit, cash, debit — whatever it is that it's being spent for. Okay? Our view at the moment is that what it's being spent for is usually quite clearly articulated — sometimes in media releases — so we can actually see what it's for. What it's being spent on and who it's being given to — because usually both of those pieces of information are made available — is the way that the bookkeeping should record the transaction.

What we're finding is that that isn't what's happening. The bookkeeping is credit, cash — that's fine; there's a cheque going out the door — and the debit is to an "other" category, which does not break it down as to where it's being spent.

[1105]

The whole purpose of financial reporting is the faithful recording of transactions and then summarization over a period of time. What we identified was that there were some gaps and differences in the way that this was actually documented. It doesn't affect the budget. No payment is made unless there's money in the budget, I would hope, so it doesn't affect the budget. It just affects the way the bookkeeping works.

J. McIntyre: But the way I understand the comptroller general's thing is that there's a lump sum of charitable that's written in that legislation. So what you're arguing is that charitable shouldn't be debited against charitable. But it has to, all of a sudden, have a category that goes back into.... It has to affect other budgets, then, if it isn't in "Other."

S. Newton: It will affect the reporting of expenditures, because it won't show up under "Other." When we break it down in the supplementary schedule by sector, those sectors will mount back to the financial statements where we have it by expense. So if we've moved it out of "Other" and put it into "Health" or whatever else, it will make a difference on the statement of operations.

J. McIntyre: Yeah, that's what I would expect.

J. Doyle: Exactly my point, Chair. Exactly my point.

B. Ralston (Chair): Everyone agrees, then.

J. Doyle: What government is doing is making a transaction and then recording it in the books differently, which is the point that we raised — that that shouldn't happen.

R. Sultan: I think both the Auditor General and the comptroller general should offer some sympathy for us confused non-accountants trying to come to grips with what your reports make very clear are at least four different accounting standards.

We have IFRS, which we read the government has directed government business enterprises to implement. We have PSAB, with or without NPO standards. I'm not sure what NPO standards are, but I suppose it's a variation on PSAB. We have Canadian GAAP, on which the Auditor General has pronounced with some vigour and clarity this morning. And we have FASB creeping over the border from the United States.

We have here at least four different yardsticks, all of which have very impeccable credentials, but all of which come up with slightly different answers to what the numbers really look like. I can appreciate that as the heading on the slide points out, accounting standards are changing. I would hope that the profession settles on one agreed yardstick at some time in the future, to reduce the confusion for the layperson.

My question relates to these varying reporting methods and the open-government initiative, which the comptroller general has referred to and which I gather has the rather ambitious objective of letting it all hang out there in one form or another, aside from FOI privacy restrictions. That's certainly a noble quest, and we look forward to the day when we maybe sit at home in our pajamas and roam through the various personal accounts, ministry by ministry, and come up with goodness knows what questions for question period next morning.

B. Ralston (Chair): That's your idea of a day off, Ralph? [Laughter.]

R. Sultan: We are threatened, in fact, with too much information perhaps.

My question is: given, or pending, transparency, is it, in the main, a question of how we organize the data and into what box and which categories? Put another way, is it either feasible or onerous to shift, if you have some modicum of understanding of accounting, between IFRS, PSAB, Canadian GAAP or FASB on your own and come up with whatever homemade statements you wish?

I guess my point and my question is: is the key issue here transparency, not how a particular version of accounting applies in any particular year?

[1110]

Is this government fully transparent in all respects so that one can, with not too much effort, switch from one version of the truth to another if one wishes? Do we make all of that information available? I'd appreciate a response from both the Auditor General and the comptroller general on that question.

S. Newton: I can take that first.

The choices we make as far as how we present financial information are in the interests of transparency. The choice — and I know we're talking about rate-regulated later — to use the U.S. standard in relation to rate-regulated accounting is to increase transparency. It sets up the regulated asset on the financial statements and liability, depending on which way the adjustments are going. Then it allows the financial statement reader to know what is yet to flow through the rates.

It's not done lightly, I think. You've adequately described in detail that there are multiple standards. I can tell you that in the year doing this job, it's been an excellent learning — that maybe I didn't want to have — around four or five different types of accounting standards. What I have learned, though, is when we move forward with some of these choices, we are working in conjunction with senior governments across Canada and looking at what the best and most transparent or faithful representation would be.

We are looking at the standards, and we are not taking lightly these choices as far as how you are going to make the decision to more transparently record something, which then also means that you're looking to a different standard along with the standard you're currently using. There's a lot of coordination, but each jurisdiction has their own challenges to face, as well, as far as the choices they make on accounting standards.

I'd say a lot of the principles across all accounting standards are close. I don't think that you could take a variety or a basket of accounting standards, pick from a bunch of them and create the world you want. I don't think that's possible. But there are some subtle differences and slight differences that are important in those particular standards for the reason that they were set up, both at the international level for the investor and at the senior government level as far as what makes sense for public sector financial statement users.

R. Sultan: You didn't really answer my question. My question was: is there sufficient data out there so that the slightly trained layperson could switch from one standard to another quite readily? Are the data already there in footnotes or in some database that's accessible to the public?

S. Newton: I would say that each set of financial statements describes the standards that they are following and, in doing so, provides the reader with the information as far as the standard they're following and how they're following it. A reader would then know, if they had some familiarity with the standard, how it's being applied.

The standards themselves are published. So you can go to the standards themselves and determine how to apply them. They're not equivalent across the board.

There are subtle differences. I don't think it's something that a layperson could work through. I think it requires a little bit of work and understanding of the individual standards.

To answer your question: no, I don't think that a person could do that. But yes, there's a lot of transparency as far as the standard that's being used and how it's being applied.

There are disagreements between preparers and auditors around the application, which is what we're experiencing.

J. Doyle: First of all, about GAAP. The government made a really good decision. I can't remember exactly when they made it, but it's just a short while back. They were going to take all the different variances and nuances of how to do a set of financial statements and bring it down to two different ways of doing it.

One is called international financial reporting standards, and that was for the training operations. The other is PSAB without any not-for-profit, which is what the NPO stands for — the same way ministries do their bookkeeping, reporting. Everything else is going to be under PSAB. A very simple process. So there are going to be two going forward into the future.

[1115]

That was fantastic. All the auditors in the room jumped up and down for joy. This was great. Then we're starting to get something else, which I've called B.C. GAAP. These are the adjustments that are being made because of aspects of the existing frameworks, both the IFRS and the PSAB, that need to be, in the view of government, changed or altered in order to provide transparency and faithfully record the real substance of transactions, etc.

It is that component that I'm having difficulty with, as to why we should change it. If the rules are wrong, go back to the standard-setters and sort it out and get it right.

So in other words, we don't have all those lists that you mentioned, Member. There are only two as we go forward. We're not there yet. It's going to take another year for the SUCH sector to get in, but within three years we'll have just two that we're talking about — plus B.C. GAAP.

When it comes to transparency, I used to teach this stuff at the master's level in universities, and I do recall the look of pain and anguish on people's faces when I tried to talk any kind of numbers. They would just roll, and they just wouldn't get it. I basically had to bring it down and say: "Well, what is the story that's in the financial statements, and how do you get to understand them without actually going off and doing an accounting degree?"

If you read the standards — it's a bit like a cure for insomnia, sometimes — it's very difficult to actually get what they're saying and how that plays out in the documentation.

There is a gap between the technicality of what is financial reporting and the knowledge base or the expectations or the readability for people who haven't got an accounting degree, and that gap should be filled with explanations that form part of the report.

Some of it's in the notes, and some of the notes are pretty interesting. So note 25 — we were talking about a little while ago, on contractual liabilities — meets the standards. We said that. The comptroller general said that. It does meet the standards, but it isn't all that helpful. You need something else to help you understand what's going on.

The story that can be read from a set of financial statements, as far as I can find, is not expressed by anyone in the province. If this were in the private sector, you would have people crawling all over these numbers and making observations and detailed internal discussions, and there would be a thing called a share price, which would be the moderator of all that thinking. There would be information that's being continually provided to the stock exchange.

Government isn't quite like that. I've yet to find a really good explanation as to what's going on in some of the documentation that's provided. So what I'm asking for is: let's make it more transparent — not so that people can go down to an individual transaction and ask, "Why did you pay this amount out of petty cash?" but to actually look at what is going on when it comes to the financial health of the province.

For example, \$80 billion is a serious amount of money. If that \$80 billion is spread over the next 2,000 years, it's not a big problem. But if it's spread over a relatively short period of time, then, hey, it is a big problem. And you don't know, based on the note 25 that we currently have.

So the transparency and being able to read the story are really important parts of what financial reporting is all about, and I don't think we're there yet. I'm trying to fill some of the gap, but I can't fill it all, because it's really about something that's included in the body of the report.

If you look at a lot of annual reports from different organizations, you actually get some of that story and that additional information that you may want.

S. Chandra Herbert: That was quite an interesting answer — \$80 billion, note 25. Concerns around B.C.'s financial health — maybe not, maybe so. We just don't know because the detail is not there.

I want to go back to earlier questions around accountability, transparency, that I raised and a number of others spoke to. In going through the report, what kind of jumps out at me is, first, on page 6.

[1120]

The Auditor relates a concern that "despite assurances, government is not actively engaging in consultation with my office regarding these significant future events.

It is normal good practice to keep an open dialogue and share analysis with the external Auditor on significant potential accounting changes, since they may well affect the audit opinion on government's financial statements."

Earlier the government comptroller said that he had been in consultation with other governments across Canada to see what practices they were taking. My first question to the comptroller is why it doesn't seem like his office or the government is doing that with our own Auditor General — leading, potentially, to these reservations on the books. Then I would ask the Auditor to respond.

S. Newton: I'm not going to put words in John's mouth, but I think that as far as the active engaging consultation, it relates specifically to the reg change. We meet with the Auditor's office at the staff level almost bi-weekly. We discuss all the issues that we're experiencing going through the year-end financial statement audit.

We also, at that level, discuss the issues that we're dealing with in looking at some of the go-forward problems we'll have in moving forward to applying public sector accounting standards, pure PSAB, across the SUCH-sector entity. So there is a lot of dialogue. I think this was more specific to, and John can clarify that as well, the level of dialogue at John's and my level — not necessarily at the staff level.

John and I have talked, and I think I've committed to being a lot more communicative this year. We've probably met more this year than we have the last year. But I'll leave him to answer that as well.

J. Doyle: It's certainly true that the comptroller general's office and my own office have a lot of face time together during the conduct of the audit. So my observation here was in regard, as we move forward, to the role of B.C. GAAP and how it's being played out and the consequences of B.C. GAAP as we go forward.

I've raised the same issue not only with the comptroller general but also with the minister and the deputy minister, and we'll see. I hope so. I mean, there is goodwill there to have these discussions and to move forward. I'm hoping it's going to make a difference.

S. Chandra Herbert: I certainly hope so too. B.C. GAAP is a big set of rules, as is IFRS, and I think it's important that consultation go ahead. I would much prefer it if we didn't have reservations on the books, if we had the ability to say with full confidence that the books state the facts as best as we can understand them and that we don't have a conflict between the Auditor's office and the comptroller.

While there may be only one reservation on the books currently, had we had a different set of financials, we would likely have had three relating to the other two reservations which have been brought up around deep-well

credits and oil and natural gas producers royalty credits. That is a big concern.

I think the general public may not see that, because accounting — you talk about that, and eyes glaze over. I think the Auditor might have made a mention around a great cure for insomnia. But the numbers matter. It's financial health.

In my reading of the report, I saw this concern around consultation. We looked at the reservations, and then we looked back to page 42, the appendices, where there are a huge number of issues, for years now, which say "not resolved."

So from 2006 there was an issue around a long-term trend analysis — not resolved. The financial statement discussion analysis — not resolved. You go to 2006, 2007, 2008, 2009, 2010 — no change. In 2011.... You just flip, yourself, through the pages here. There is a large range of issues — accounting for First Nations settlements, classification of debt, authority to borrow.

It just concerns me that what it looks like here now is government going off in one direction while the Auditor stays where the Auditor is, which is due in part to the legislation, because it's his job to be talking very openly about transparency and accountability.

[1125]

I guess I would just like to ask: has the relationship broken down? What's going on here? This is not a healthy report, in my view, around keeping government honest and accountable.

S. Newton: I would say the relationship between the offices is good. It's professional.

There are a number of these issues where they're not issues currently. We have disagreement. They're not significant enough to affect the year-end financial statement audit opinion. If you go back to the audit opinion, the audit opinion materially states.... I'm not going to bother reading it, but there's one qualification. Otherwise, the financial statements are fine. They fairly present what happened over the course of the year in a material way, and the one reservation is an issue with a zero-dollar-value net effect on the bottom line.

Everything else is the issues that we disagree on, none of which are material enough to affect the reader's understanding of the financial statements. I think we both understand that. We do review a number of the issues, as circumstances change, on an ongoing basis. So it's not like these are parked and we don't look at them again. We reassess them.

There's quite a rigorous challenge process in the financial reporting and advisory service office in relation to these. We consult with our Accounting Policy Advisory Committee, as well as other jurisdictions, on these issues, to determine whether our choice is appropriate or not.

As you can see by this list, we have not changed much. We are still working on some. Some take some time to

work on. But if we go back to the audit opinion on the financial statements, none of these will have a material effect on the reader's understanding of government's financial position or the activities it undertook during the year. That's John's opinion, not mine.

B. Ralston (Chair): Mr. Doyle.

J. Doyle: Thank you, Chair. I think the question was about our relationship.

One of the things about an opinion is that you've got to understand what an opinion means. This concept of "materiality" that was raised means that the figures are within several hundred million dollars of where we think they should be, and as long as they're within several hundred million dollars of where they should be, we say: "That's okay." So it's not.... You can't get a precise figure.

As a professor, the first thing I did when I was teaching accountants at master's level was actually to show them why every figure in a set of financial statements is, in fact, based on estimates and other things. I could actually disprove every one of them, including cash. You've got to understand the framework within which we work and operate in order to get it.

Anyway, as far as the relationship is concerned, I'm looking forward with some hope that the relationship will grow and become better, but I must say that this is most unusual for me. I have worked in several jurisdictions in my life, and I've never seen a list like this of issues that need to be resolved and a lack of response to them.

I want to go through that complete list to make sure that I understand them. I mean, you've got stuff in here that's pretty basic to me and that would help transparency.

For example, if numbers are changed from one year to the next.... In case you haven't noticed, they change every year. There's usually a little note in the financial statements. Some of us won't be able to read it because it's a six-point font — okay? There is a little note, but the note only tells you half the story, because it doesn't detail all the changes that have occurred. So we said: "Well, include the complete note." Then you end up with the argument: "Well, that makes the financial statements longer and longer and more complicated for people to understand."

There is a balance between transparency and how much should be done and how things should be changed, but I think that the figures do change from year to year. The reason I found out that they change from year to year, by the way, is because I keep models which I use to track long trends when it comes to government financial statements. I keep them myself, although my teams do something similar.

I suddenly realized that my model wasn't working because the numbers were changing each and every year in different aspects. I couldn't figure out why for a while.

Then finally, I figured out what was going on, and the numbers were actually changing — not huge, but they were changing.

[1130]

The classification of numbers does change from time to time, but usually both columns change and there's an explanation for it. When I looked through this list of things that we're talking about, some of them are to do with transparency, some of them are to do with the reality of the transactions, and some of them are to do with just good financial management and practice. But what concerns me is "not resolved," "not resolved," "not resolved" all the way through them, when I think that a lot of them could be resolved quite easily and could come off this list. I don't think it would take a great deal of time, effort or energy to do so.

S. Chandra Herbert: Thanks. I would tend to agree, although I'm no auditor, and I'm no accountant. But some of the stuff here looks pretty basic and, I think, would provide the public with a fuller view of what government is actually doing.

I understand that the comptroller suggested there was no challenge, I guess, around the bottom line, around what the actual numbers would look like. But in reading through the Auditor's report, we see things like the failure to provide for deep-well credits, which means that in the fiscal 2010-2011, the suggestion is that expenses are understated by \$205 million and liabilities are understated by \$339 million. So the deficit for the year is understated by \$134 million.

There's a similar concern around the inappropriate netting of the oil and natural gas producer royalty credits. When we're dealing in government, obviously there are challenges with financials; there are challenges with dollars. So government will say things like, "There is no money for arts and culture or for health or for education," or things like that, and: "Look at the deficit."

Well, I have a hard time squaring that when we see things in this report with a suggestion that either the deficit is understated by \$134 million or the deficit is overstated by \$50 million in the case of the natural gas royalty credits. I'm curious how that works with what the comptroller previously said around how it doesn't change the financial outlook for the government — the Auditor's concerns.

S. Newton: When I was making the statement about not having a net effect, that was in relation to the Transportation Investment Corporation. It's a zero-dollar effect. The rest was.... I made the comment that they weren't material, and we've already had the discussion around material.

In relation to those two items — deep-well credits and the netting of royalty credits — we've been consistent with that practice for quite a number of years and

are consistent with other jurisdictions that have similar situations. It's been discussed previously in other Public Accounts Committee meetings on this.

The legislation in relation to those two spits out a number at the end that includes the credit in there when they're calculating the royalty rate. By showing those numbers on our financial statements, including the revenue, that would overstate revenue. That would be revenue that was not available for programs, not available for any other purpose. It merely exists to work out the final number on the calculation in the legislation that spits out the royalty rate.

Same with the deep-well credits. Other jurisdictions that have it deal with it the same way.... We go through this.... Every year we review this to ensure that we are accounting for it correctly. This year, as well as in previous years, we are satisfied with the treatment that we are taking as meeting Canadian generally accepted accounting principles.

B. Ralston (Chair): Mr. Doyle, you had a further comment?

J. Doyle: One of these reservations doesn't have an impact on the bottom line. But what it says in the standards, and the way I read the standards, is that revenue should be shown gross, and then expenditures should be shown as expenditure, and then the net effect is the same as if you had netted it off. It's a fundamental principle, with the exception of tax, that you actually show revenue, and you show the associated expenses as two separate items in the operating statement, and then you come to the result.

[1135]

We do differ from government in our regard to this. When I look at other jurisdictions, the differences that I see between the way B.C. has its process, I see it different than the other provinces — from Alberta, and I think Saskatchewan is the one they chose. They are fundamentally different, but it doesn't affect the bottom line. I think the comptroller general is right about that. It's the presentation of information in the report.

The other one talks about actually creating a liability that is then consumed by those that receive the credits, usually in the following year. There's a high probability that those things will be consumed in the following year. So we know that they're going to be consumed. We may not know the exact figure, but we can make a pretty good estimate. It's up in the nineties, I think — 90 percent.

Now, if those were brought in — and they're included on an unadjusted errors list — that would have increased the deficit. But if the entire unadjusted errors was brought in, my guess is that it would have increased the deficit slightly, but it would not have been a significant figure. The size of the variation, as I say, is below a couple of hundred million. That's the materiality level that we

used. So what you can say is that the result was \$300 million, but it could have been \$400 million — you know, that kind of level of calculation.

Based on \$55 billion worth of sales and everything else, that's pretty close precision, although I would agree with anyone that \$100 million is a lot of money and could be used for a lot of things.

So I think I'm happy with the way that the opinion has come out. I just wish sometimes that these issues weren't in the bucket of "unresolved," and we would like to see them cleared up.

K. Corrigan: I'm going to ask a question on the contractual obligations in a minute. But there is also an area in this report where there is a real impact, in my reading of it — and I know we're going to talk about it later, because we have another report on B.C. Hydro — and that's in rate-regulated accounting, where it will have a real impact on the future books of the province, in my understanding. But I know we're going to talk about that later — I mean, to the tune of \$450 million a year.

My question and comments are on the contractual obligations. In one year in this province we had our long-term contractual obligations increase from \$53 billion to \$80 billion, which means that our long-term contractual obligations now are much higher than what is called "debt" in this province. I note that for 2012, for that one year, the contractual obligations that we have are \$8.6 billion. On a budget for the province of about \$40 billion we're talking about more than 20 percent of the budget being spent on contractual obligations.

I really appreciate the work that the Auditor General is doing in encouraging greater transparency, more information and greater clarity of reporting of these contractual obligations. As the Auditor General said: "Contractual obligations have a significant impact on the degree of service delivery and...how these services are delivered now and into the future. Furthermore, the expected payment streams associated with these obligations directly impact the remaining amount of discretionary funds available to government to meet future needs."

The recommendations that the Auditor General has talk about more disclosure of the anticipated payments; expanding supplemental contractual obligation disclosures to ensure that stakeholders have access to information that they might find significant; terms and conditions of contracts; and description of the rules used to compile supplementary contractual obligation disclosure.

[1140]

I'm wondering if the Auditor General could just provide further comments so that we have that on the record here, and any response that there might be from government, because it is a real concern to me that we have such high contractual obligations into the future. Perhaps I could get comment from the Auditor General on that.

J. Doyle: I think it's a requirement of any prudent financial manager to know the impact of all their contractual liabilities as they go forward. You've got a number of ways of providing funds to deliver services. In the government world, it's taxation. It's debt. The other side of the coin is the delivery of services over time and the commitments that have been made and also, in this particular case, contracts that may have been signed.

I might point out that this figure complies with GAAP, but it still doesn't include the RCMP contract, which is the example I've used for the last couple of years. Because it has run out, it drops off. Until it is signed, it doesn't come back on. So it's \$80 billion plus whatever the RCMP contract is. That's just an example. There could well be others.

I struggle hard to find what is secretive around many of these contracts. There are some components which may have some commercial in-confidence components where intellectual property or otherwise may be there. But the fact that there are going to be payments for the delivery of services is usually something that is expressed, and I think some information can be made available.

The danger is, of course, when you open the door a little bit and then someone kicks the door in and wants to get to know everything about everything that's going on. I think there is a balance between the right and proper role of government to keep things close to themselves and the provision of information to citizens in regard to the financial health of the province and where we're likely to be as we go forward.

I was speaking recently at a P3 conference, and one of the issues I raised that hit a nerve was: how do you know you can afford to pay for these transactions going into the future when you have competing challenges or competing bids for resources to deliver essential services? I have yet to see documentation anywhere, although it's something I'm thinking of conducting audit work on, to look at the financial health — not just debt-to-GDP, not just simple performance indicators, but the financial health — of how it is that the province, as it is moving forward, could actually meet all its obligations as and when they fall due.

I suspect that it's out there somewhere, this forward thinking, but I also expect that most citizens are pretty keen to understand, to be confident that it's happening. This is just one component of that looking forward. When I looked at the TIC model — I'm not going to give details, because I'm not sure yet whether it's still confidential or otherwise — what I was looking at was a model of how tolls could be received over a period of time to cover a debt that had been created to build the bridge. You could see it all laid out.

Something similar needs to be done for the whole of the province going forward. It's not easy to do. But making sure that we don't overextend the use of alternate

means of financing, or commitments that we've entered into — P3s are included in these calculations — to ensure that, in fact, financially, as we go forward, we're actually healthy....

I think that's the point I'm turning my attention to. It's not detailed in here. What we're talking about in here is more about more information, which I think is reasonable, because it is available, and information that is provided so that it's got a utility, so it's not just a PDF that you have to trawl through. When I heard and when I've spoken to government about the open data process, that is a welcomed initiative to actually get more information.

I'll stop there.

[1145]

K. Corrigan: Can I just ask a really quick question? It's very short, I promise you.

John, you raised the fact.... For example, the RCMP contract is not included. I was looking, actually, at the 2012 versus the 2013 contractual obligations, and there was quite a big drop there. So 2012 is \$8.6 billion and, at this point, 2013 is about \$4.8 billion.

Does that partially explain why there is the drop? I mean, it's still very significant, but there is a big drop in one year there of the contractual obligations. Is it things like the RCMP budget? Is it expected that that number for 2013 will increase significantly with that and other obligations?

J. Doyle: There is a big drop. On the table which is on page 75 of *Public Accounts*, you can see within each category where the drops are. The RCMP one that I was talking about comes under the "Protection of persons and property," and it goes from \$313 million down to \$23 million. I have no idea what the contract is, but my guess is that the \$23 million represents liabilities that have been signed, sealed and delivered but does not represent things that are in the pipeline, as it were.

So please, no one is hiding anything. This is exactly in line with GAAP. It's just that when you read the story, you've got to ask the question: what does that mean? You can't find out what it means without going into more detailed information in other places.

If you look at some of the others, there are some quite big drops. I haven't done any detailed analysis, although my staff have got the complete breakdown of this, and as I say, I'm thinking about what future work I might be doing.

B. Ralston (Chair): Thanks. Next is Doug, and then what I'm going to suggest is that after he asks his question and we have the response, we take a break for lunch. There's something that's been delivered here. We would take about a ten-minute break and then come back after that.

But go ahead, Doug.

D. Horne (Deputy Chair): I have to say that with all of the discussion about financial standards and accounting practices, one of the things that I think the public in general would be well served by is coming to a standard that has the abundance of transparency and trying to maintain it to a certain extent.

Unlike the private sector, which has been alluded to in some of the reports, it's not necessarily the same type of analysis that's used in governments. When you deal with the private sector, what happened last year compared to this year is an important analysis.

When it comes to government, I think it's much better for the public to be able to analyze what happened five or ten or 20 years ago, compared to what's happening now, and to look at much broader and longer trends than what, perhaps, someone might do in the private sector. So by continually and constantly changing the standards by which we report, and by restating those numbers on an annual basis, I think we're actually doing some disservice when it comes to the public.

As we've heard here today, both the Auditor General and the comptroller general have said that even within the standards that we're currently reporting, there are deficiencies. There are ways in which they don't necessarily provide the type of disclosure that the public is looking for. So I think that that's an important factor as we go forward.

The one issue in coming down with this.... Obviously, the biggest disagreement at this point and the reservation that exists has to do with the TIC. As the comptroller general has said, if you were to move to a line-by-line consolidation, which is the recommendation of the Auditor General, the net effect of that is still zero. But obviously, there's a disagreement over the presentation of that and the principle that allows for that line-by-line consolidation or not — the way that it's dealt with right now.

[1150]

The one question I would have.... Obviously, in my background in corporate finance we talk about a trading company; we talk about a going concern. I would assume that there would be similar analysis done on a going-concern basis to a trading company.

Obviously, exploration companies aren't making any money. They're going out, and they're exploring for resources and raising money in the public markets to be able to do that. Obviously, one would assume, and in most cases it would be true, that on an annual basis their auditors would view them as a going concern and would account for them on that basis.

So I ask a little bit of a broader question. That is: when it comes to consolidating, as the Auditor General has suggested, on a line-by-line basis at this point, because the Auditor General himself has said that at some point, indeed, this may be a self-sustaining trading company, which would require for it to be accounted for how it

is right now.... I guess if you reclassified it now, at what point would you reclassify it back? Going back to my original point: is the reclassification back and forth actually acceptable under GAAP, and is there any precedence to that?

J. Doyle: Thank you for the question. We did look to see whether there was any new GBE right across Canada that had come in, and how it had been dealt with, and we couldn't find any help there. Basically, it appears that when this modified equity arrangement came in for consolidation.... It's only for consolidation, so the TIC's financial statements are correct. There is no problem with the entity's financial statements. It's just the way they are brought into the bigger picture of the province.

We couldn't find any previous examples anywhere. We thought we had one once, but not. So we have to fall back onto the existing situation and the standards. The standards give us four tests that we follow, and TIC satisfies two of the tests. They're a separate entity, and they can manage themselves. But there are a couple of tests in there that are critical for them to be classified as a trading enterprise. One of them is simply that they sell services, and it's the bulk of their business, outside of the government reporting entity. It's in the present tense.

They don't sell anything at the moment. Well, they sell hope, I suppose. But there's no money coming in. The question would then be: if they don't sell anything yet, how can they be regarded as a trading entity? Now, I've seen the financial model, and I'm not sure how much I can say about the model, so I'll just assume that it's still completely confidential, and I can't talk too much, except in generalities, about it.

The financial model I've been shown shows how, over the next 30 or 40 years, income will be received from tolls to meet all the obligations of the entity, including paying down all the debt, all the interest, and maintaining its operations till it gets to the point where it's debt free, and then, presumably, it would revert back to the province.

Some of the assumptions in that model, I'm having discussions around, because I'm not so sure about them, and I'm not sure that they're actually in the public arena. The model, by the way, shows that the enterprise will break even on an operating-statement basis in about 2017 and would actually break even on an equity basis — so that's accumulated losses are wiped out by accumulated surpluses — in about 2024.

My difficulty, as we go forward, is: at what point is the tipping point where it's more likely than not likely that, in fact, they will be a going concern and they will continue to operate?

[1155]

They won't actually make a profit for some years, and then they won't clear their accumulated losses for a few more years beyond that. But according to the entirety of

the model, if nothing changes — and of course, we live in a world where nothing changes — then they will be able to pay everything back.

That's the discussion I still have to have, because I need to check the robustness of the model and ensure that it's fit for purpose. It's good enough for me to make the assessment at the moment, but to make the assessment about when it becomes a government training enterprise, I'd like to see some performance and some tolls.

I've noticed, for example, that other toll bridges are not achieving some of the toll targets that they were set, and that's causing a few problems. If I were to factor those into the model, which I have done, it has a very different outcome going forward. So I've got to wait and see until I get more precise information about actual performance once the tolling starts.

B. Ralston (Chair): Mr. Newton, did you want to add anything?

S. Newton: Yeah. You don't set up an enterprise to fail. You actually set it up and there's the expectation that it will do well. The modelling is what helps you decide whether this is going to work or not, and that's the basis that you use to decide how you're going to treat this entity.

Over the normal course of its business it will take care of itself without government support. That's the determination that was made at the time. That's the determination that was supported by the rating agencies at the time when we talked to them in 2009.

GAAP does allow for you to change, so right now we believe it will not need any support from government. Should circumstances change over time and new information be known that would cause us to believe something different, that would be the point in time where we would change whether or not it's self-supported to taxpayer-supported. But that would require new information to be brought to the table.

At this point we can continue with it the way it is. Should we get information that causes us to believe differently, well, then GAAP does allow for us to treat it differently on a go-forward basis.

J. Doyle: I'm sorry, Chair. What we slipped over there was rating the entity as a GBE and debt. I actually believe it is self-supporting debts. That's what I'm getting from the model — that the only payment stream to pay this debt off is going to be from the tolls. I think there will be enough of them. Whether it takes the X number of years that's predicted in the model or 200 years, I don't know. But I know that the tolls are going to pay for the debt, so I agree with that.

But under the definition that currently exists, if the entity is not recorded — this is government's definition — as a GBE, and I don't think it can be at the

moment, then the debt is taxpayer-supported debt, not self-supported debt, which is why I've made the recommendation to change the definition of debt.

The second thing I'd like to mention, which I didn't know until just now.... I've just been given a note. This perhaps reflects my lack of history in this province. In the mid-1990s B.C. took over a pulp and paper company. It was going to be a GBE, and it was traded as such. But it never made a profit, and two or three years later it went bankrupt.

Now, I am not suggesting.... Please don't put words into my mouth. I said: "That looks like the TIC." But basically, there is a reason why you only get recorded as a GBE once you start delivering surpluses and profits. I'm just sticking to the letter of the standards as they sit at the moment. That's what they say, and that's not what's happening yet.

B. Ralston (Chair): Great. With that, we'll take a ten-minute recess and begin promptly at ten after 12.

The committee recessed from 12 noon to 12:14 p.m.

[B. Ralston in the chair.]

B. Ralston (Chair): Members, I'm going to call the meeting back to order. We're continuing our discussion of the report of the Office of the Auditor General, *Observations on Financial Reporting*.

I had myself next on the list. I wanted to pose a question to both the comptroller general and the Auditor General. It relates to the recommendations that are set out on page 28 with respect to contractual obligations. The Auditor General did, I think, begin to touch upon this.

In the public accounts there is a measure which is called the interest bite, which measures the amount each year of the budget that's consumed by interest payments. I'm wondering whether it would be possible to devise a forward-looking measure of the annual financial impact of contractual obligations.

It seems to me that unlike debt, where there can be defeasance, or unlike other government programs where there can be reductions in staff or sale of capital assets, contractual obligations impose very inflexible obligations upon the government to pay in accordance with the contract.

[1215]

Is that something that is possible as a measure? I think that would be helpful to the reader of the financial statements.

S. Newton: That would be something that would be considered probably best in the financial statement disclosure and analysis versus the financial statement itself. I'm not sure what that measure would look like. There's always the risk in forward-looking measures

that you have to be pretty clear on what the basis of your measurement is. You don't want to put in too many assumptions, because then it could be misleading.

I think as far as forecasting and what's going forward, there are other vehicles for that, being three-year service plans or government's plans forward. Those provide more clarity as to how we're going to be using resources going forward.

Contractual obligation is only one piece. We've got a large component of staff that have jobs and would be expecting to be working on in the future. Any decisions you make in relation to staffing have financial impacts going forward as well. I find it interesting that we fixate on the contract dollars, but service is delivered through people that we have on payroll as well.

The broader discussion of how we are going to get things done with the pot of resources and the requirements that we have show up in the budget planning forward, especially in the out years. But as far as a performance measure or some sort of analysis, in the FSD and A — and I'm just thinking out loud as I'm going through this — it would be more what has occurred over time.

I'd have to think a little more carefully about what a forward-looking measure would be, at least in the financial statement versus something that would be in a government planning or strategy document.

J. Doyle: My take on this is that such measures need to be within a suite of measures that are looking at the financial health of the province as it goes forward. I would agree that in the financial statements themselves it probably would be of limited value. But in budget documents and in the commentary at the beginning of the *Public Accounts*, it would probably be quite useful.

R. Hawes: I'd like to preface my question and remarks by defining "government." In my question, and I'm assuming in some of the answers we've already heard, the term "government" isn't referring to the B.C. Liberal government or.... It removes the politics. My question is more along the lines of.... When I say government: the entity that belongs to the taxpayers and represents the taxpayers and the best interests of taxpayers, removing the politics totally. So my question would be....

To take it to a much higher level than some of the specificity that we've heard today, what I think I'm hearing is that the Auditor is saying there are standards that really should be changed, and it would be in the best interests of the taxpayer as a whole if those standards were changed. But we're getting out ahead a little bit of those changes and, perhaps, from the comptroller's standpoint, doing reporting that's in the best interests of taxpayers that really is in compliance with some of the other standards. But as we work towards changing standards, we might be a little bit.... And we're a leader,

I guess, in pushing for those changes, and other governments are doing the same thing.

I think what I'm hearing... The Auditor has also said that he's pretty strictured by legislation as to the standard that he has to use in looking at his audit process. That's just pure Canadian GAAP. There's no other.... He can't be looking at other things. The legislation has bound him to look at something, and when we vary from that, he has no choice but to put a note that we have strayed from what he must look at.

I think he's saying it's not necessarily in the best interests of the taxpayer as a whole, and to get to what's in the best interest of the taxpayer, we should pursue the change in standard before we actually report differently. Is that sort of...? So we're doing what's in the best interests of the taxpayer, but we haven't let the standard catch up.

Would that be pretty much what I think I'm hearing here from the Auditor and perhaps from the comptroller?

[1220]

J. Doyle: First thing, I have some problems with the term "government" as well. When I first came here I'd never used the phrase "government" in any of my reports. When I read them, it was the "ministry," or it was the "entity," or it was the "organization." But in B.C. "government" is used in a different way. So when I say "government," it's that amorphous mass of everything. It's not necessarily a particular group of people that sit in the House; it's the whole.

My guess is that some of these difficulties that government is trying to address through B.C. GAAP are partly because of issues with the standards and the way that the standards are constructed and partly to do with other things. I haven't actually asked anyone a detailed question on this, so I'm just surmising at this stage, and I hope you take my comments as the musing of an Auditor General rather than a defined statement. A lot of these issues....

B. Ralston (Chair): These are going to be abbreviated musings, I hope? Okay. Thank you.

J. Doyle: I think some of the changes are based around the optics of the bottom line, rather than faithful reporting. In that respect I would challenge government to look at.... Government should live within its means and be able to demonstrate that to citizens. That's what financial reporting is supposed to be all about. That's what budgeting is supposed to be all about. But the measurement of that is distorted in the way that the framework currently works. Because of that, B.C. GAAP is becoming live.

I'll give you an example. It's not a live example at the moment, but it will be an example in the future. It's the TIC. At some time in the future they're going to make a \$100 million a year surplus. I've just picked the figure

out, but just say that they're going to make a \$100 million a year surplus for that year. That's going to appear as a profit. That's going to be rolled into the summary financial statements, and it will look like government, for that particular year, has made a \$100 million profit, because that's what the BTAA says.

The reality is that not one dollar of that \$100 million is available to government because it's all going to be used for a particular purpose, which is payment of principal and clearance of a debt that exists, that's self-supported debt.

We've found a couple of other examples where looking at the financials and the way that they operate, there is a tendency to have a look at the bottom line rather than to look at good financial management.

School districts are another example. They've got \$1.2 billion worth of cash trapped in amongst school districts — cash — but they can't spend it all because if they spend it, they'll start to have difficulties with their bottom line, and that will have an impact. And yet school districts make a \$100 million a year profit each year. They made \$100 million last year. Yet most school districts I've visited have told me, with tears in their eyes, that they don't have enough money to buy the biscuits, never mind make \$100 million profit.

There's something about the way that it's all structured and put together that isn't as clear as it could be or as it should be. As a result, conversations then take place which are miscommunications in regard to what should be a faithful representation of the financial health or otherwise of the province.

So I think that the province itself needs to move forward to find a way to faithfully report its performance, not only in the current year but going forward, and to demonstrate that it has good financial health — that's through the budget process or through other reports that it has to do — because the real issue here is not about the accounting standards. The real issue here is about how you report performance, and that's not a conversation that we've had yet. Did that help?

[1225]

S. Newton: A couple of comments. Accounting standards set by the province aren't driven by the bottom line. They're actually driven by what would be most transparent and accurately reflect the economic substance of the transaction. It is true that there are consequences to the choices that do affect the bottom line. So in talking about a change in standard, you talk about it in terms of: "Here's the change. Here's what faithfully represents the economic substance. Here are the impacts."

When we get to the impacts level, there are effects on the bottom line. People tend to focus on the bottom-line effects, but at least in the realm of choosing accounting standards, it is focused on what faithful representation is. I guess I'm starting to take exception to the term "B.C. GAAP."

Let me just clarify a couple of things. GAAP in British Columbia is defined by the BTAA, Budget Transparency and Accountability Act. No other piece of legislation has defined GAAP. The word "GAAP" lives there — not Canadian GAAP; just GAAP — and it doesn't state a clear definition.

The change to the BTAA, when it occurred, was for three key reasons. One was to define GAAP, because we hadn't defined GAAP in the province yet. It was defined as GAAP for senior governments in Canada, and that was specifically referring to PSAB.

The second piece was to broaden the authority of Treasury Board in relation to accounting standards across the whole entity. That allowed Treasury Board, when changes were occurring, to be able to direct entities to either be compliant with IFRS or compliant with PSAB.

The third piece, and the piece that we'll probably spend a bit of time on when we deal with rate-regulated accounting was to provide some flexibility to be able to deal with the changing world of standards. At the time this was put in place, rate-regulated accounting was still an open question. There was lack of clarity which way it would go.

IFRS, international financial reporting standards, is still undertaking a massive harmonization project with U.S. GAAP, so some of the things in IFRS may change. IFRS did have an exposure draft on rate-regulated accounting and how to deal with it. There was a 50-50 split, and it was dropped. It's still an agenda item on the International Accounting Standards Board's agenda, and they did come to Canada at, I think, about the end of October, beginning of November to talk to industry and government about the rate-regulated issue as well. It's an open question.

What that third piece in the BTAA change allowed us to do was to be able to — this goes back to a comment that was made earlier — provide consistency and comparability until we get to clarity. Sometimes being the leader means that you are kind of on the wrong side of the standard at a point in time in order to be clearer and more transparent.

R. Hawes: Just thinking about what the Auditor's musings were.... When I look at the reservations on the financial statements, basically, I would read them as being there because of what you must audit in compliance with the act and looking at GAAP and there have been some different standards applied, and that's what's led to, really, some of the reservations that you've put on the financial statements. Would that not be correct?

That's what comes back to my question. This is less about the musings and the clarity that you've talked about, which I'm sure the comptroller would agree — that, you know, if there are some suggestions, we should be looking at further clarity. I mean, there are ways that we can do that. But in terms of the overall financial

statements, do they reflect fairly the position of the government, and are they transparent?

I guess from the position of the Auditor looking at the standard you must use, you have to put that reservation on. I think that's all I'm trying to say. And the comptroller is saying, "We've looked at some other standards that are," in the opinion, certainly, of the comptroller and Treasury Board, "more in the best interest of the government" — not the B.C. Liberal government but the government as a big entity, reflecting taxpayers. It's in the taxpayers' interests. I guess that's where my question was — less about the musings.

[1230]

J. Doyle: Okay, all right. B.C. GAAP. The reason I've used the term "B.C. GAAP" is because the province — not the government, the province — is basically bringing in adjustments that do impact the bottom line. I'm looking at deferred capital contributions. It impacts the bottom line — not at the consolidated level but at the entity level. I'm looking at rate regulation. It does impact the bottom line in both the entity and at the consolidated level.

What I'm seeing is a dissatisfaction with the current structure and form of standards. The response is to bring in legislation that shifts away from an adoption of accounting standards that was undertaken by the province in 2005. What has happened, as you so quite rightly point out, is that the House, in the legislation, has made it clear to me that I need to look at GAAP and to keep that there.

I do see a difference between GAAP and B.C. GAAP. That's why I'm starting to differentiate. I've only started using the phrase recently. There is a difference. It is emerging as a different form of GAAP that is being used within the province, both for financial reporting — not for the day-to-day bookkeeping sometimes — and the perception that citizens would have on that financial reporting because they could read from whatever's published the story that has actually occurred.

I think the musings are dead-on, and it's really an issue around what motivates these changes. What motivates these changes? It wasn't me that said: "Let's drop not-for-profit accounting." It wasn't me. "Let's drop the 4400 series." In the 4400 series you could do some of this stuff that is still in the pipeline. It wasn't me that said that — okay? It's now the 4200 series, by the way, just to confuse life.

The province decided that. Then, I think, my view, my take on it is that they're going to bring in a regulation that allows them to do what they were doing before, and I have difficulty with that. That's what Ontario has done. It has not been done yet in this province, and it may actually be something that isn't going to happen. But my expectation is that it probably will. I have some difficulties with that based on the rules that I've been given in the legislation, which are quite explicit. You wouldn't want me to stray away from them, so I've got to stick with them.

J. Rustad: I just wanted to make sure this wasn't going back and forth for yet another round.

So contractual obligations. I want to understand something about this. There are a number of contractual obligations that are on the books, and those obligations are associated with 3P projects, whether that's the Sea to Sky Highway or whether that is the Abbotsford Hospital or whatever other project that may be out there.

I understand what the Auditor General said earlier with regards to "it may limit choices going forward, associated with dollars chasing services," but at the end of the day, unless you want to be in Montreal with a bridge collapsing, there needs to be maintenance done on a bridge, and unless you want the power plant failing in a hospital, there needs to be maintenance done on that. Those obligations, I suspect, are justified going forward to maintain the capital asset that the money's been invested in.

The question I've got around this from an accounting perspective is: if it is a contractual obligation that over the next 30 years this is going to be maintained, what is the difference on the books between having that as a contractual obligation or government having to pay for that on a yearly basis as part of its own inventory of maintenance that it does? What would end up being, over the course of that time, the actual physical difference between us saying that we're going to have janitorial services that are going to be paid for by the government, for example, year after year after year versus a contract that is a commitment over 20 years to provide the same sort of services? How would that be different in terms of the budget side?

[1235]

I guess at the end of the day, as well, I remember a report that came out around 3P projects that showed the benefit that came from it in terms of the incremental investment and benefits that we get, over what would have happened if government had done it internally. I guess, how do you weigh that obligation versus what would normally have to be done? How would that look on the books? Then, how does that additional benefit from having that 3P project get actually accounted in as part of our overall budget and financial reporting?

S. Newton: If you're going to do direct service delivery, it won't show up in contractual obligations. Let's say we've got a contract for a million dollars over the next five years to have janitorial services. Under "contractual obligations," it would show up as a million bucks in each of those five years. If we were delivering the service directly, we wouldn't have a note for the next five years in relation to that.

Now, each year the service is dealt with. So each year — under the contract or government doing the service — is when the expense shows up. We actually pay the contractor for having done the work that year or pay

our staff for having done the work that year. The staff cost going forward, if it's internal, doesn't show up. That would be the difference there. You would budget for both of those the same, as far as that over the next five years, you know, you've got a million dollars in service delivery requirements, either by staff or by direct service delivery.

The financial statements aren't going to answer the question with a big number over here that says the savings from making this choice versus that choice. You have to do some analysis on "we did direct service delivery" versus "we had this contract, here are the services that were delivered, and here's what the cost difference is." That would be an analysis that you would do outside of the financial statements to determine the benefit.

J. Rustad: Thank you. What I'm hearing is we have a bunch of contractual obligations that are on the books, but in theory — because of the need, whether it's maintaining capital stock or it's going forward on other things — that money would be spent anyway, by choice, of course, by government internally, and it would still show up on a year-to-year basis. So there is no difference on the books associated between government making a choice to do that versus a contractual obligation. Is that correct?

S. Newton: Except for the note in the back of the financial statements that says we have contractual obligations. But on the revenues and expenses, the assets and liabilities, it shows up the same.

J. Doyle: It's an extremely good question. It's in fact an example of proactive disclosure, which wouldn't normally be there — to actually have the contractual obligations note — because it's telling you about things that are committed and that you're going to do.

The example that the comptroller general used a little bit earlier was: you've got staff, and you're going to keep those staff, and yet you don't see them anywhere in the balance sheet or anywhere in the financial statements as an obligation going forward, except for pensions and things.

The actual salaries themselves — by the conventions that we use for accounting and reporting, we don't actually show them there for the next however long they're going to be with us. So in fact, it's putting onto, and putting notice to, citizens the fact that these ongoing obligations are there. That has got to be good, whether it's a P3, a contract like the RCMP, or some kind of other arrangement that has been put into place. That's positive.

But there's a word of caution. It has got to be put into the context of what you can afford as you go forward. It isn't always the same cost for us to maintain a hospital as we go forward if it's under a contract or if it's the province doing it itself. I'll give you the reason why.

Whenever there's squeezing of budgets and so on, one of the first things that goes is training. After train-

ing, it's usually maintenance. If there were a royal society for protection of buildings, government would probably be told, "You can't have any more buildings," because government traditionally defers expenditure on the maintenance of the fabric of buildings. These contracts don't allow you to do it. You actually get locked in for high-quality work that you need to do. That is the nature of a P3. They keep it up to a certain standard.

[1240]

The danger is that in times of pressure, the province would have access to: "Let's defer stuff." In the future you will not have access to that same block of funds to defer things. You'd have to actually find the additional resources that are required from a different source, because you're locked into these payments.

What it does — again, I haven't assessed it, so I don't know if this is a big problem at the moment — is it reduces the flexibility that's available and pushes the province into action that may be different if these contracts didn't exist. From my perspective, all I'm saying is that the consequences of the \$80 million need to be carefully considered in the context of the financial health of the province as it goes forward. Can you pay for this and keep paying for it rather than keep borrowing or whatever? That's all.

J. Rustad: Just as a follow-up, if I may, to that.... I thank you for that, because that's actually very good advice in terms of being able to do that going-forward budgeting. But I would also argue that with the several hundred billion dollars' worth of infrastructure deficit that is present across Canada — if that was to be held, on an ongoing basis, as part of contractual agreements that we have today, we probably wouldn't see that infrastructure deficit. It would have been locked in and paid for and going forward and part of budgets and part of having to maintain fiscal responsibility. But anyway, thank you for the comment.

J. Les: My comment and possible question is in the same vein. We hear concern about long-term contractual obligations, and it's usually in the context of expressing great concern. The reason we're here is to make sure the long-term financial health of the province is sustainable. So properly expressing what those long-term contracts are all about, I think, is very important.

I was a little concerned earlier when I was listening to the discussion that the long-term contract with respect to policing drops right off at the expiration of the RCMP contract. Well, it isn't as if policing is going to stop at a given moment in time, so I'm wondering if there isn't a bit of a skewing of accuracy in terms of expressing government's obligations going forward, even in the absence of an RCMP contract.

I think the Auditor General made a comment earlier that there is much work to be done in this area. I would encourage that that work be done, if at all pos-

sible, because we are moving more into an area where government services are provided by contract.

I know in many cases that is a bit of a philosophical debate, but one of the issues that arises from providing services in that way is the avoidance of risk and, as has already been indicated in the earlier question, probably a greater adherence to proper maintenance of the facility or the infrastructure. I think those are quantifiable, as well, in terms of their long-term benefit.

I think it would do a great public service if those things were more clearly understood, because it's one thing to say, "Oh, my goodness, we have \$80 billion worth of long-term contractual obligations," as if it were only handcuffing government. I think we need a proper delineation of the benefits as well.

I would welcome any comment that anybody would have.

S. Newton: Well, I guess, as a preparer, I'm trying to figure out how I would clarify, in a set of financial statements, some of those thoughts. I think that would be a different piece of work.

One of the things with financial statements — traditionally they are past-looking. As far as being able to define in a set of financial statements where we think the future's going to be, how well we're set up to be able to either reap the benefits or understand the risks of how we've locked ourselves into contracts — I think there's opportunity well beyond the financial statements.

[1245]

If we're looking at the financial health of the province or we're looking at how information about how well the province is doing can be provided, year-end financial statements are a pretty strict package that have some very specific requirements to them. There are other documents, like planning documents as far as strategic plans or budgets going forward or forecasts. Those kinds of things can be more forward-looking as far as where we think government should be going or how healthy government is at a point in time.

It's worth considering and spending some time to figure out how this could work. I don't, off the top of my head, have a simple answer as far as how that kind of information may be more adequately reflected in financial statements. I suspect they would be reflected elsewhere.

J. Doyle: At the moment, the note complies with standards. The reason that the RCMP contract is not there is because it's not a done deal. Therefore, that gives rise to my comment that the \$80 billion is understated by the size of that contract. There may well be other contracts, as well, that are out there.

It would be enormously difficult for the province to actually figure out what was in the pipeline and to include them in a note which goes, on a prospective basis, into what's going forward, yet I think the province does need to do it in order to know that it can actually cope

with that stream of payments and the delivery of that service as it goes forward. Even if they didn't want to publish it, they would still need to do it for good financial management purposes.

The whole idea of having small contracts that lock you in for certain expenses is fine, but you've got to add them all up at some point and decide how much you can afford — you know? This is the equivalent of lots of small payments being made in respect to the overall size of government, but after a time they become a pretty big weight in your rucksack.

P3s. We're going to do some work on P3s. But I was in Toronto quite recently, and I was listening to.... And I'm probably going to get off this guy's Christmas card list now, because I'm going to share what he said. We were listening to him talk about a P3 that had recently been completed, and he couldn't say enough that was good about the building, the way everything was delivered on time, on budget and everything else. And I thought: "Well, that's good. That's moving some of the risk."

But then he went on. I haven't checked his figures, but he basically said: "It's going to cost us less to operate. We're not going to have the acquired infections that you normally have in hospitals. The rate has come down quite significantly. The staff is better able to do things because of the way that they rearranged the way that they designed the building."

Now, if all those things come through — and this is the bit he hates because I'm going to quote him: "We can make savings." And I thought: "Yeah. You'd better not say that too loud, because somebody, the province, might remove the funds from him" — whichever province it was. But it seemed to me that there are new ways going forward, and it's not just about the bookkeeping sometimes. It's the accumulation of the good effects that could occur.

Now, that doesn't mean to say that I agree with every P3 or I disagree with any P3, for that matter. It's just that in this particular case, because they were able to sit there and see the consequences of what was going on, they could actually see a reduction in the kinds of ongoing costs that would normally be expected, which was a good thing, and it just doesn't show up anywhere in our way of reporting financial results.

We come back at the end of the day to.... The financial statements are a technical document that is produced in a certain way, but then the story has still got to be read separately, and it's the story that I think we're missing at the moment.

B. Ralston (Chair): Do you have something further, John?

I've got Guy and Vicki, and then I think we're going to move to the other report.

G. Gentner: Well, in the brevity of time, maybe I'll just ask the Clerk to clarify how I can facilitate further

questions — I mean, there's lots of meat on the bones on this report — sort of like written questions. Can I offer them to the committee so they'll then be sent to government and the Auditor General and taken on notice — and hopefully, a reply? Is that a possibility, rather than taking the time from staff or from this committee?

[1250]

B. Ralston (Chair): If there are further questions, perhaps we could leave.... I'll have to discuss with the Deputy Chair before I would make a decision. One option would be to leave this meeting open in the sense of an opportunity for further questions and do them in writing and then to have them come back to the committee at a future time. Before I make that decision, I'd like the opportunity to discuss with the Deputy Chair.

Maybe before we conclude, there could be a resolution just directing us to meet and make a decision about that.

G. Gentner: Okay, I'll therefore put my faith in the committee to allow that to happen. Like I say, hon. Chair, there are a lot of different questions here. There are a lot of questions from the last meeting — the environmental assessment. We had stuff from the oil and gas before that, I think, would be well worth our while to pursue, perhaps in a different manner.

B. Ralston (Chair): That's something the Deputy Chair and I will take up.

Then, with the understanding that the Deputy Chair and I will advise the committee as to how we will proceed in the future or whether we've concluded our consideration of this report, we'll adjourn this hearing.

If we could take a brief recess of five minutes, we'll set up for the next report.

The committee recessed from 12:51 p.m. to 12:57 p.m.

[B. Ralston in the chair.]

B. Ralston (Chair): We're going to deal with the report of the Office of the Auditor General, *B.C. Hydro: the Effects of Rate-Regulated Accounting*, dating from October 2011. I'll turn it over to the Auditor General to introduce his team.

I'm not sure who's going to be the leader. Perhaps Mr. Reid from B.C. Hydro could introduce that group as well.

**Auditor General Report:
B.C. Hydro: The Effects of
Rate-Regulated Accounting**

J. Doyle: I have with me today on my left, Michael Macdonell, an assistant Auditor General within the office,

who will be giving the brief presentation. On my right I have Ken Ryan-Lloyd, who'll be handling the technology.

B. Ralston (Chair): Go ahead, then.

L. MacLaren: Hi, I'm Les MacLaren. I have the electricity and alternative portfolio in the Ministry of Energy and Mines. I'm joined by Charles Reid, executive vice-president finance and chief financial officer of B.C. Hydro, and Cheryl Yaremko, who's Hydro's chief accounting officer.

B. Ralston (Chair): Welcome to everyone. We'll turn it over to Mr. Doyle to begin.

J. Doyle: Last year I determined that a review of B.C. Hydro's accounting practices, specifically those related to rate-regulation, was in order. Around the time my staff began their work, government commissioned its own financial and administrative review of B.C. Hydro. I, therefore, deferred the release of my report to allow for the completion of government's review and to tailor my comments to avoid duplicating the review's recommendations, on which the province and B.C. Hydro were already committed to act.

There were two concerns for me. The first was that the growth of these deferral accounts cannot continue indefinitely. The province's own report forecast a significant increase in the net balances of these accounts in the coming years, and I'm concerned that there does not appear to be in place an approved plan to reduce a balance of all of the accounts, let alone hold their growth.

[1300]

My second concern is that discussions regarding the disposition of deferral accounts should be supported by a comprehensive understanding of B.C. Hydro's financial condition. Of particular interest is that, effective next year, the deferrals permitted by rate-regulated accounting will no longer be allowed, due to changes in Canadian generally accepted accounting principles. The increased transparency that this change will bring is very positive, because it brings to the forefront the consequences of financial management decisions and highlights the challenges that lay ahead.

Unfortunately, government has taken a different position — which we will explain and go through, and we've already commented on earlier on — and is in the process of implementing a strategy that would likely avoid the transparency required under Canadian accounting standards.

As members are no doubt aware, my act prohibits me from calling into question the merits of program policies and the objectives of government. I have not done so. Government asserted that adopting rate-regulating accounting is a policy decision. I disagree. In my view, the policy is about rates and the maintenance of those

rates at reasonable levels that are easy to forecast, not the process to achieve that.

Government's policy to provide sustainable electricity at a low cost to consumers — I'm not allowed to comment on; although, I totally agree.

Achieving this policy or any other policy concerning electricity rates does not require the use of rate regulation.

I will now turn over to assistant Auditor General Michael Macdonell to provide members with a brief overview of our report.

M. Macdonell: Thank you, John. Good afternoon, Chair, and members.

B.C. Hydro is responsible for the generation, manufacture, transmission, distribution and supply of electrical power across B.C. It's the largest publicly owned utility in the province and is integral to province's economic prosperity and the quality of life of its citizens.

The utility industry, including B.C. Hydro, is regulated by a provincial agency — the B.C. Utilities Commission, or BCUC. Of particular note, BCUC is responsible for reviewing rates. One of government's objectives is for stability and predictability in electricity rates. Prices do not rise and fall with the cost to B.C. Hydro of producing or having to buy a unit of electricity in any one year.

To be clear, the rates charged to customers is a policy decision of government on which we, the Office of the Auditor General, make no comment.

The Auditor General looked at B.C. Hydro's rate-regulated accounting practices in order to bring to the attention of legislators and the public the significance and growth of net costs that have been deferred and their impact on B.C. Hydro's financial condition.

Deferrals are a normal accounting practice. For instance, the cost of significant assets are routinely deferred and amortized over a number of years, recognizing their long-term economic benefit. That's not what we're talking about today.

The accounts we're talking about do not qualify for deferral under normal accounting standards. Nonetheless, they represent dollars that, for the most part, have been spent by B.C. Hydro and will eventually have to be recouped.

B.C. Hydro uses rate-regulated accounting to defer expenses and revenues to future years in order to smooth out the effects of unexpected costs or windfall profits rather than represent these fluctuations as expenditures or revenues in its financial statements.

It's important to note that, up until now, rate-regulated accounting has been allowed under Canadian generally accepted accounting principles. Last year B.C. Hydro's financial statements received an unqualified audit opinion from their independent auditor.

As B.C. Hydro has applied to the B.C. Utilities Commission to have its rates approved, it has asked that certain types of costs or surpluses be eligible for deferral. These

deferrals have had an impact on reported net income, which has in turn impacted dividend payments to the province.

B.C. Hydro first established a deferral account on March 30, 2000. This account was known as the rate stabilization account. The account allowed B.C. Hydro to achieve the annual rate of return on equity allowed by BCUC by transferring amounts to and from the account as needed, depending on the projected net income for the year.

In 2004 the rate stabilization account was cleared out, and government issued a regulation effective for 2005 and beyond that mandated BCUC to allow B.C. Hydro to establish more specific deferral accounts as required.

Over the six-year period since 2005 the balance in these new deferral accounts has grown from \$182 million to \$2.2 billion, as at March 31, 2011. The net balance is comprised of 27 different accounts, according to B.C. Hydro's most recent annual report.

By government's own estimate, the balance is predicted to grow to nearly \$5 billion in the coming years. As shown on this graph, B.C. Hydro's use of deferral accounts has greatly exceeded that of comparable public utilities in other jurisdictions.

[1305]

In addition to keeping electricity rates stable, government requires Hydro to earn a specified rate of return on government's investment in the utility. Provincial legislation requires BCUC to ensure that B.C. Hydro's rates allow it to collect sufficient revenue in each fiscal year to enable it to achieve its target annual return on equity.

The province has established an annual return for Hydro relative to the pre-tax return on equity of Terasen Gas, now part of FortisBC. For the year ended March 31, 2011, the target rate was 14.3 percent. In addition to meeting the required return on equity, B.C. Hydro is also required to pay a dividend to the province, its only shareholder. The most recent dividend, accrued for the year ended March 31, 2011, was \$463 million.

To achieve its target return on equity, B.C. Hydro needs revenues to exceed expenses by a certain amount each year. For the March 31, 2010, fiscal year the target return on equity of 13 percent assumed that budgeted revenues would exceed budgeted expenses, creating net income of \$402 million. However, at the end of the year actual expenses exceeded actual revenues, creating a loss of \$249 million before deferrals.

To achieve the target return on equity, \$696 million in expenses were deferred. This resulted in a final net income of \$447 million and a return on equity that was close to the required target.

Net deferred costs represent dollars that will eventually have to be recouped in some way. Allowing the balance of deferred costs to grow only serves to move the financial burden further into the future. While deferral accounts can be helpful in ensuring rate stability,

significant costs deferred today may be unfairly passed on to future ratepayers, who receive little or no benefit. This concept of potential unequal matching of costs and benefits is known as intergenerational inequity.

The legislation governing B.C. Hydro requires BCUC to set rates such that deferrals are cleared within a reasonable time. "Reasonable" isn't defined. However, BCUC endorsed four to six years as reasonable for costs of energy accounts.

We found that the cost of energy deferral accounts are not being recovered in four to six years. The plan for some deferral accounts is for them to be recovered over longer periods, and approved recovery plans do not yet exist for all deferral accounts. Compounding the time it will take to recover costs is the interest B.C. Hydro is paying itself on the balance of these accounts.

We consider that the current trend of escalating deferred expenses is not sustainable. It's unclear how B.C. Hydro plans to recover the significant balance of deferred costs and over what period. We therefore recommend that government determine, at the earliest opportunity, how B.C. Hydro will recover the net deferred costs in its regulatory accounts.

Accounting deferrals of this nature confuse the need to achieve legitimate policy objectives with the objectives of transparent financial reporting. Financial management decisions are focused on ensuring the viability of the business enterprise, whereas the purpose of public financial reporting is to serve the interests of transparency and public accountability by describing objectively the results of financial management, using an agreed-upon reporting framework.

Rate-setting is a financial management decision. Impartially communicating the year-to-year results of these decisions is the purpose of financial reporting.

The report highlights what B.C. Hydro's financial results would look like without rate regulation, as shown by the red line on this chart — the exhibit which is on page 11 of the report. The green line represents income as reported. The red line shows income with the effects of net deferrals removed. The blue bars show that dividends paid to the province exceeded income without deferrals in 2005, 2006, 2008, 2010 and 2011.

The graphs on page 12 of the report show that at the same time as dividends exceeded income without deferrals, B.C. Hydro's total debt was increasing, and its net equity — government's investment in Hydro, in other words — otherwise known as retained earnings, was decreasing.

Government's report noted "concerns that the extensive use of regulatory accounts reduces transparency of the financial information." We agree. In our view, rate-regulated accounting has been obscuring financial management decisions that have been made because, among other things, it creates the appearance of profitability where none may actually exist.

[1310]

Rate-regulated accounting is currently acceptable under Canadian generally accepted accounting principles, or GAAP. Going forward, rate-regulated deferrals will no longer be allowed under Canadian GAAP.

However, rather than accept the transparency that will be required under Canadian standards, government has instructed B.C. Hydro to adopt part of an American accounting standard that allows for rate regulation, known as FAS 980. It's interesting to note that to avoid potential conflicts of interest, FAS 980 requires the regulator to be independent of the regulated utility. Since both B.C. Hydro and BCUC are controlled by government, it's inappropriate for B.C. Hydro to apply this standard.

We consider the situation unfortunate and urge government to reconsider. We therefore recommend the government prescribe that the annual financial statements for B.C. Hydro be prepared fully in accordance with Canadian generally accepted accounting principles.

L. MacLaren: Chair and committee members, it's a pleasure to be here this afternoon. I am not an accountant, but I am joined by a couple of experts in the field.

As you've heard from Mr. Macdonell, the Auditor's report focused on rate-regulated accounting at B.C. Hydro and some other selected Canadian utilities. As he mentioned, the review was in parallel with a broader review of B.C. Hydro that was undertaken by government. That broader review also identified concern over the size and growth of B.C. Hydro's regulatory accounts and also made recommendations with respect to capital structure and dividend policy.

The government review recommended that B.C. Hydro "work with the province to perform a more in-depth review of the growth of regulatory accounts and determine a more sustainable approach" to utilizing those accounts over the longer term. And you've seen the Auditor's two recommendations already.

Contrary to what some members of the committee may have heard in the media when this report came out, rate-regulated accounting is legal and is consistent with Canadian generally accepted accounting principles. The Auditor stated that in his report and has stated that here today. The practice is used by both publicly owned and privately owned utilities. In B.C. implementation of deferral accounts has been a policy decision to reduce the volatility in and stabilize rates.

Our regulatory accounts have been in use since the early 1980s, and oversight of these accounts, both in terms of establishing them and clearing them, is subject to approvals by the British Columbia Utilities Commission. As Michael noted, there are currently 27 existing or applied-for accounts. At the highest level, they cover variances between forecasts when rates are set and what actually occurs and also, more generally, to match costs to the beneficiaries of investments that are made.

This table is maybe a little bit easier to see in your handout. It sets out the categories of regulatory accounts and the current and projected balances in them. The first group deals with forecast variances to account for items beyond B.C. Hydro's control — water inflows that vary from year to year; trade income, which is influenced by market prices; exchange rates; storm restoration costs and things like that.

In B.C. Hydro's service plan they note that these sorts of forecast variance factors can cause swings of as much as \$700 million in a given year, which would be about a 20 percent rate impact.

Variances from forecast should average out over time. If significant balances are owing from future ratepayers, the BCUC has established a rate rider to bring those balances down. In current rates today there is a 2½ percent rate rider which generates approximately \$100 million a year to pay down the balance of the accounts.

The majority of recent growth has been very low water conditions in the past few years, which has necessitated additional purchases beyond what was planned and lower than expected trade income due to low market prices. In the next five years the balances in the forecast variance accounts are expected to decline.

[1315]

The second category is capital-like accounts, where costs are allocated to future ratepayers who are benefiting from investments. A good example here is demand-side measures, which benefit ratepayers over time. The recent growth in this group of accounts has been to the high level of investment that B.C. Hydro has been making in demand-side measures as they strive to meet 66 percent of demand growth through conservation and efficiency and, as well, some costs related to Site C.

This category of capital-like accounts make up 80 percent of the projected growth in overall deferral accounts over the next five years. The drivers there are — again, for their spending and demand-side measures — Site C, the smart metering and infrastructure program and the classification of overhead in property, plant and equipment as B.C. Hydro transitions to international financial reporting standards.

The third category at the bottom of that chart is mostly non-cash items and provisions, such as First Nations costs and environmental provisions. The recent growth in these accounts has been due to settlements with First Nations, most notably the St'at'imc and the First Nations around the Williston reservoir and some new PCB regulations that have resulted in the provisions for the environment. Future growth in this area is primarily the treatment of pension costs, also with the transition to international financial reporting standards.

In summary then, the regulatory accounting is a policy choice the government has made for rate stability. It's consistent with government's intent, as set out in the committee stage of the budget implementation bill in 2010.

These accounts are consistent with current GAAP, and with the amendments to the Budget Transparency and Accountability Act in 2010 and the Treasury Board regulation issued earlier this year, will remain lawful going forward.

The effects of rate-regulated accounting will continue to be fully and transparently disclosed in the notes to B.C. Hydro's audited financial statements as well as in the government's public accounts. I believe that there were more than four pages' worth of disclosure around these accounts in Hydro's most recent annual report.

The government is not alone in making this policy choice. Both public and private utilities are choosing to adopt U.S. GAAP to continue the practice of rate-regulated accounting. Some examples there are Fortis, which has both natural gas and electric operations in British Columbia as well as operations in other parts of Canada; TransCanada corp., a major pipeline company; and Hydro One in Ontario. All are making that choice.

Earlier this month the Canadian Accounting Standards Board announced that it would recommend to its international counterpart to reinstate the standard-setting project on rate-regulated accounting. I think, as the comptroller noted earlier, there's still quite a bit of debate in this area in the accounting community. We do share the Auditor's concerns over the size of deferred amounts, which will grow as B.C. Hydro invests in its system and in further conservation measures.

A big piece of the projected growth over the next five years — about \$1.3 billion of the \$3 billion in projected growth — is related to the transition to international financial accounting standards. The combination of the rate rider, the averaging effect of forecast variances and the matching of today's cost to future beneficiaries are the mechanisms that will reduce these balances going forward. I expect — well, I know — this will be a topic of considerable discussion at the revenue requirements proceeding before the BCUC, and B.C. Hydro just filed its amended application yesterday.

That concludes my comments, Mr. Chair.

B. Ralston (Chair): Great. Thanks very much. Questions?

K. Corrigan: My understanding of the reason for rate-regulated accounting is to smooth ups and downs in what can be a volatile area in terms of expenses and revenues. But that doesn't seem to be what has been happening with rate-regulated accounting with B.C. Hydro. What has happened, essentially, is that there is none of the ups, and there is all of the downs, so that what we have, it appears to me, is simply a huge deferral of costs, which are creating huge debt, which eventually we're going to have to pay for.

I think the most telling part of this report, or an area where it's well encapsulated by the Auditor General's report — which I thank you for, Mr. Auditor General,

making something as confusing as this actually understandable....

[1320]

You say:

"Financial management and public financial reporting have significantly different purposes. The purpose of public reporting is to serve the interests of transparency and public accountability by describing objectively the results of financial management using an agreed-upon reporting framework.

"In our view, rate-regulated accounting as it is being practised is not consistent with this objective. Not only does rate-regulated accounting obscure financial management decisions that have been made, it allows management, sanctioned by the regulator, to determine how results will be publicly reported, rather than following objective standards of presentation."

And what follows after that is the example of achieving the target return on equity.

It's astounding to me that essentially what happened is that \$696 million in expenses were deferred. So that \$696 million of costs that were there was deferred in order to turn a \$249 million loss into a \$447 million income. To me, that's just — sorry — sleight of hand. It doesn't make any sense whatsoever. Then that creates the return on equity. But it's simply.... To me, it seems like sleight-of-hand accounting.

I'm not going to ask a question at this point. That's just an observation. I find this.... You know, I said last time we met that there was a very damning report that we had on another subject, but this one is to me quite astounding. I'm wondering, on that specific issue, whether the Auditor General has any further comments.

J. Doyle: Whilst, on the face of it, it looks surprising, it's in fact allowed under the current regime of accounting standards. The purpose of this report is not to challenge what is, at the moment. It is where to go to from here. These numbers are going to go up quite significantly, and we were not able to detect any plan or process by which these accounts would be cleared going forward.

The second component was that we had some difficulties with the divergence away into B.C. GAAP, which we discussed earlier.

It seems to me, Member, that what we tried to do here was simplify a process, and it is more complex than you can believe. But we simplified it without losing its focus.

I will state on the record that it seems to me that the sole purpose of this whole exercise is to achieve a return of 14.3 percent so that a dividend can be paid to the province.

My view on that is.... I can't remember whether I expressed it in the report or not, but the consequence of that process is that the necessary liquid assets that any entity needs to reinvest in itself are being withdrawn from B.C. Hydro and taken elsewhere. The consequence of that is that self-supported debt is being created to fill the gap, and taxpayer-supported debt is being avoided because of the transfer of liquid assets.

B. Ralston (Chair): Mr. MacLaren or Mr. Reid, did you want to respond?

C. Reid: Sure. Good afternoon, everybody. I think there was a whole series of issues within that last little section. One thing I would like to say is that we actually do spend an awful lot of time on this in B.C. Hydro. We spend an enormous amount of time in front of the Utilities Commission on this.

It is correct that this is intended to smooth out costs over time. That's absolutely right. But I think that, contrary to what has been talked about before, this is entirely about generational equity. That's exactly the reason why this is done.

[1325]

I'll give you a simple example of how this works. Mr. MacLaren mentioned demand-side measures. Most of you would know that as Power Smart. I mean, that's the most common.... Everybody knows about Power Smart in B.C. We're very proud of it in B.C. Hydro.

What we will do, taking next year for an example, is spend roughly \$200 million on our Power Smart programs next year. If we did not have rate-regulated accounting, then we very likely would charge that out in rates that year. But it has lots of adverse consequences. In fact, just on its own, that one item would probably impact rates by 5 percent.

It's very unlikely that we would pass that through to net income and create a loss, because it actually isn't the province's cost; it's a ratepayer cost for the future. Again, that creates problems on the rate side, but I totally disagree that the premise that we would create losses in B.C. Hydro's books would occur. I think that's an assumption.

The choice would be: where would that cash go? What would you do with it? My premise would be that that would be charged to ratepayers at that time. Now, that would be very unfair. From a generational equity point of view, it would be very unfair, because those Power Smart programs, we believe, have benefits lasting over ten to 15 years.

So should today's ratepayer pay for something that's going to benefit a ratepayer 15 years from now? We don't think so, and that's the issue around a lot of the growth. That single account is the largest account that we have now and in the future. In fact, you saw in the slide earlier that that's growing to \$1.3 billion.

To us that is a receivable from customers, and we will match the cost of that to the benefit of customers, going forward.

B. Ralston (Chair): Any further comment from the Auditor General on this?

J. Doyle: If there are benefits that are long-term from any activity, there are provisions within the standards to collect those costs and to carry them forward and amortize them. You don't need to go to rate regulation to do that.

What I've just heard is: "We're going to try and reduce over time the demand" — I think it was demand — "on the assets that we've got." Well, I don't see how you need to transfer that through to someone in 15 years' time. If you're reducing demand now, and you're investing now, and it's a capital project which has got a benefit, then you will reap those benefits as you go forward, with less demand. Therefore, you can push back the step cost that's required to increase the capital assets of the entity.

So I'm not following the approach that's described — which is allowed, by the way, under rate-regulated accounting. That approach is allowed. I'm just not following it.

My view is that as we go to the point where rate regulation no longer becomes available, then something has got to happen. The province's approach to that at the moment is to bring in an American standard, or part of an American standard — not the whole standard, but part of an American standard. The bit they've missed out is the independence of the regulator.

I just can't see at the moment — and it was all that we recommended — how these very large sums of money are going to be cleared as we go forward. You know, I've learned a bit more today. But actually, if I go back to my file notes, I think I'll find all that information in there as well.

I'm looking at the consequences of this large rat-in-the-snake type of situation and how it gets cleared out over time. It's a big bump that's going to be there, and it's going to be there for a long time as it gets digested. I think it's going to have an impact, but I'm not quite sure what it is as we go forward. When we asked the question, we didn't get an answer — at least not one that we were accepting of.

Can I just make one other observation, as well, about transparency? If you look at B.C. Hydro's financial report — which is excellent, by the way — all this is written down and detailed in there. All this information has been around for a long, long time. This is no sudden revelation about something that's not been about.

[1330]

It's actually been documented in there very well over the years, and the openness of the Utilities Commission, the transparency of that process, is also there, and it's all been there.

One thing has changed, though, recently. In the past B.C. Hydro used to report its financials to result, then adjust the result for rate regulation to give the final result. What happens now is that the numbers to get to the result are adjusted, so you actually have to dig and delve a bit to find the figure of what the adjustment was.

You can find them. They are in the annual report. But you just have to go digging in the notes to actually get that information. I think that's a backward step in transparency as well, although it's not mentioned in the report.

B. Ralston (Chair): Mr. Reid, you look like you want to respond.

C. Reid: Sure. I think the debate over the value of Power Smart and how we treat that has been well dealt with in numerous hearings in front of the Utilities Commission. It is our customers and the Utilities Commission that have agreed that these benefits for Power Smart and other programs last over many, many years and that that should be allocated over many years. There is certainly no debate amongst our customers on that.

Notwithstanding that the Auditor General doesn't understand how that works, we have a lot of evidence to support the benefits that match that over time and the costs that are tied to that. The fact that that account, particularly, is growing means that we are investing a lot into Power Smart and conservation, as is required by us under the Clean Energy Act. We are actually, again, as I say, very proud of that and think that's an excellent program, providing benefits to future customers.

With regards to the transparency of all this, everything we do in front of the Utilities Commission, all of this information on regulatory accounts, is public on a regular basis. We file all sorts of reports with the regulator on every dollar we spend in these regulatory accounts.

We develop plans about each individual account as we go, with the regulator. They approve the creation of the account in the first place, they approve the dollars that go into these accounts, and they also approve the recovery period of these accounts from customers. I don't think there's anything as transparent as that that we do with anything else within B.C. Hydro.

The statement that the Auditor General is making around the change in the financial statements.... Yes, we did make a change in the financial statements. But I think if you look, we have a very clear note and table in our financial statements so that you can easily find the adjustment in regulatory accounts from year to year.

G. Gentner: First of all, to the Auditor General, I'd like to thank you. I've learned a few terms here today, and I'm looking forward to understanding more of what B.C. GAAP is. Maybe I'll find it on Wikipedia. John, I want to make sure you understand that you will be on my Christmas card list.

Ralph mentioned about PJs and Christmas. I know in the States, Stateside, today is known as Black Friday, but seeing this report, this should be known as Red Friday. I concur with Kathy. I think we have a very serious situation relative to how our public utility is being run.

One quick question, and then the main question. My understanding is that Hydro is preparing an amended revenue requirements application by the end of November to the BCUC. I wonder when that's going to happen and if we're on time on that.

My main question is to do with what's called "Response from the Ministry" in the report on page 8, whereby the ministry states that it will be looking at, with regards to the intergenerational payback.... The "provisions represent significant one-time adjustments for costs which should be recovered. Setting up offsetting regulatory accounts provides for recovering the related costs over a reasonable time period."

I'd like to know what "should" is and what is a "reasonable time period." The Auditor General, on page 13, refers to it as well. He questions what a reasonable time period is — that it's not defined in legislation. We talked about four to six years to recover the costs to deferred accounts, but the Auditor General suggests that it's not happening.

Is there a plan? What is the plan here? When are we going to have this payback? There's no plan to stop the growth of regulatory accounts. How will deferred costs finally decline by 2021, as suggested?

[1335]

Maybe the Auditor General could put more light on it, but I'm certainly wanting to hear what the plan is from B.C. Hydro.

L. MacLaren: The amended revenue requirements application, including an appendix with some analysis on intergenerational equity issues and the paying down using the rate rider, was filed yesterday with the BCUC.

Secondly, each account, as Charles was noting, is different. There is discussion with both customer groups and the regulator in terms of how an account will be paid down. As I noted, the majority of the growth in these accounts going forward is related to capital-like accounts, where they will be matched to the beneficiaries of the investments, be it Site C or smart meters or other investments that are being made, and they will work out with the commission what the payback period of those will be.

B. Ralston (Chair): Does the Auditor General have any further comment on that?

J. Doyle: The only observation that we made in the report was that there should be a plan. I'm just re-reading the response from the ministry, and I can't see anywhere that they say there is a plan, although I get that there may well be reasonable expectations that they may have as to how this will actually play out over the next few years.

The provincial review on B.C. Hydro that was conducted didn't detail how these large sums were going to be cleared. In fact, what it showed, if I remember the graph correctly, was that they went from \$2.2 billion to just shy of \$5 billion, although I notice \$5.1 billion in one of the slides here, and then they go flat, which implies that for what's coming out, more's going in. I don't

know if that was right, or whether it was just an error in the graph. We didn't do any analysis because we weren't given any information about how these balances would change over the next period of time.

The obvious question that we raised was: how is this going to be managed going forward? I still don't know.

B. Ralston (Chair): Mr. Reid or Mr. MacLaren, did you want to respond?

C. Reid: I think part of the issue is the fact that we have all these different accounts. We tend to look at these individual accounts uniquely, and in terms of a specific approach, process, plan, we often don't look at the package together, although that is an issue. We say, within B.C. Hydro, that we're very clear on a plan and approach to the regulatory process on the accounts and how we handle it.

I wasn't asked for a specific plan during the process from anybody. If I had been, I would have done the same thing. I would have gone through all the 27 accounts and talked about the approach and process around every single one.

I think the fact that these accounts are growing isn't necessarily the issue as much as: what is the investment we're making here? Why are we making the investment, and is that investment a good investment? Just like we spend money on our capital programs, on our major dams and generating stations, they're investments in the future for B.C. Hydro and for ratepayers. These accounts are really no different.

It's just in the case of the large growth that we're talking about here.... Les talked about capital-like accounts. Well, I think there's a reason we use that term. They don't meet the clear, today, accounting definition of "capital," but they certainly meet the "logical, reasonable man" definition of capital in terms of benefits for our customers. That's why we end up deferring those costs and do not charge today's ratepayer for them.

A really good example of that.... Again, most of you know we're working very hard on Site C. We're spending a lot of money on prefeasibility and so on and engineering and archaeological studies, environmental assessments and so on, on Site C. I think the accounts today have about a hundred million dollars in there for Site C.

Now, that project, if approved, will not be in service until 2021 or thereabouts. Should we charge today's ratepayer for an asset that will not be serving them for ten years? We believe not. We believe that legitimately, that balance should be held and charged to future generations of ratepayers, not today's.

[1340]

The fact that those accounts are growing is really talking about the investment we're making in the system for the future, no different than any other capital project that we have, like a dam or maintenance on a substation.

J. Doyle: The business world is full of capital projects. The accounting standards are full of processes that you follow to accumulate costs and then defer them until the capital project is in place. I suspect that many of the members would be familiar with that kind of process.

What we're talking about here, if they're being capitalized in a rate-regulated account, is expenses that do not fit the parameters for deferral under GAAP. Okay, if that's the case, they can then fall under rate regulation, and if that's what is happening, then so be it.

The question is.... It's all right to have an intention that these things will be recovered at some time in the future, and it's okay to look at the different accounts on a one-by-one basis. The questions we asked were specific. What's the plan to get rid of the \$5 billion? We still don't know what it is, and it's not mentioned in their response. If there was a plan, the first thing I would have done, if I'd received this from the Auditor General, would have been: "We have a plan, and here it is."

That didn't happen. Nor did it happen in any of the discussions. I can remind the members that the process we go through, when we start talking about collecting the facts and making sure that we actually agree with an entity, is that we've got the facts right. We've got them on the right handle and everything else.

If we had been given a plan, we would have removed the recommendation because there would be no need to have the recommendation if a plan existed or was presented to us.

So I have some difficulty still with, first of all, the way that these accounts have been managed over time. It seems to me that they have shifted from a relatively small amount, with some kind of defence against fluctuations — and there's evidence of that in the rate rider; it's there, and it's \$100 million a year, that type of thing — into something that's quite different.

Again, I would just point out that the way it looks, and the way it was described to us by some, was that basically, it's an adjustment after the fact, to achieve the required rate of return in order to generate a dividend to the province. That being the case, it sort of undermines a lot of the logical, sensible presentations that are being made to the Utilities Commission regarding why these accounts should exist and how they're going to be dealt with and recovered over time.

I look at the substance of what is occurring. What has happened is that over the last few years several billions of dollars have been removed out of B.C. Hydro, and they have had to go to debt to get enough money together to actually invest in their capital programs, to a greater extent than they would have if they had their own internal capital resources.

B. Ralston (Chair): Spencer's next.

Interjection.

B. Ralston (Chair): Okay, I didn't really mean to cut you off. I didn't catch your....

C. Reid: Sorry about that.

B. Ralston (Chair): We can keep going back and forth, if you wish. I think it is actually helpful to the committee.

C. Reid: I just wanted to make one more comment on the issue of the plan. I was never asked for a plan. My staff were never asked for a plan. As far as I know, the ministry was never asked for a plan. So I'm not sure what the disconnect was. I've never talked to the Auditor General before. I've never met him until today. I just think that there's something missing here.

We actually believe very strongly in what we're doing with this. We believe it is in the best interests of ratepayers. We believe it is a better solution. Taking all the accounting issues aside, in terms of a practical approach, we believe that this is the best approach for ratepayers. That's been well supported with an established process with the Utilities Commission and our customer groups.

S. Chandra Herbert: Well, this is just a quick question. I've got other questions, but just coming off that response. The comptroller, the government, suggests that it was never asked for a plan. The Auditor General is pretty clear that they did ask for a plan. I'm just wondering if Mr. Doyle might shed some light on the suggestion that they were never asked for a plan.

[1345]

J. Doyle: I'll just describe the end of the process, rather than the detail of an actual conduct of an audit. When we're nearing the end of an audit, we go through a fairly rigorous process with the entity that we have been auditing to ensure that we've got our facts right.

The first stage of that is a facts-clearance-type process, where we actually say: "This is what the situation is; this is how we understand it. Is this right or wrong?" We then go through a process where we provide a copy of the report. We go through that to make sure the nuances are right or wrong, the commentary regarding those. We make edits and changes in regard to that if the entity believes that we should and we agree with their point of view. Then, finally, we provide them with a copy of the final report and ask them to respond to it.

There are two recommendations in this report. The first one I'm going to mention is around GAAP, and there is a response to that in the response from the province. The second one is: where's the plan? I'll leave it to you — dot, dot, dot.

S. Chandra Herbert: Thanks for that answer, Auditor General.

Looking at the graph on page 11, it's pretty striking to me that, I guess, as of 2001 the two lines flip, so we have

"Reported net income, with deferrals," ending up on top and "Reported net income, without deferrals," ending up on the bottom. They stay relatively close until 2006, and then, in specific, to a much greater degree in 2008. My reading of it is that in 2008 it looks like about a \$100 million, maybe a \$150 million, difference to 2009. I'm not sure where in the year. It's quite greater.

A quick question. I understand we've got the numbers for 2010-2011. What would the gap have been in that 2008-2009 year had we been doing accounting as the Auditor General has suggested would more accurate or, at least, more understandable by the public? It seems to diverge wildly from that point on, which happened to be an election year.

J. Doyle: Could I just correct the member? Rate-regulated accounting is allowed.

S. Chandra Herbert: Sorry. I understand that. I'm just referring to your suggestion that it might be clearer if we did this in a different way, not that it was illegal or something like that. What if there hadn't been rate-regulated accounting?

J. Doyle: What would have been the result if there had not been rate-regulated accounting? I think it would have been the red line on the graph.

S. Chandra Herbert: Okay. I'm just curious what the financial difference would have been, because I see that the numbers are kind of there, but it's not exactly clear to me. Maybe that's an impossible answer, but....

J. Doyle: We can get the information, but it's about \$150 million dollars difference. The reason we showed it as a graph is because it's a picture, and we didn't want to use tables to give all the detail, but the tables behind this particular graph were all extracted from the annual reports over this period of time. So they're straight out of B.C. Hydro's reports, and we've used their numbers to actually create this table.

S. Chandra Herbert: I would appreciate those tables, to get past that graph, which is just so striking. But it's hard to... I would like to ask, using that piece of the American standard that the government has decided to do — and I will say "government," because it is the government that has made this decision, the B.C. government — why is there the concern about conflict of interest between Hydro and BCUC? What kind of possibilities would the Auditor suggest could happen under this standard that the government has chosen? Why is this important?

[1350]

J. Doyle: Well, initially the importance is that it's not Canadian GAAP. I think the point has been made that

the jury is still out as to whether or not rate regulation will continue within Canadian GAAP, but that actually doesn't make any difference to the thrust of this report, which is: what's going to happen to the \$5 billion?

I don't know whether IFRS is going to permit rate regulation or not. I do know that the institute has extended the use of rate-regulated accounting by one year. The original request was that they extend it by two years, but that was brought down to one year. It may well be extended again. I don't know.

I think the 980 is an American standard. What it's based on is an independent regulator ruling on submissions made to it by a host of different entities, whether they be in the public or the private sector. The regulation that has been put forward and is now in place says that the entire standard will not be adopted. The bit that relates to "there must be an independent regulator" has been excised from the standard, and the bit that has been left is the kind of processes that you see here. My guess is that would mean that the Utilities Commission would continue in its current role, and this process would continue as it is at the moment.

That's the import of the whole exercise, but to me the issue is really around moving away from Canadian GAAP in the first instance.

L. MacLaren: I don't think there's really necessarily a conflict at all between B.C. Hydro and the BCUC. The U.S. standard.... I think in most of their markets you either have elected public utility commissions or they are regulating investor-owned utilities. In B.C.'s case, the Utilities Commission Act and the Hydro and Power Authority Act are both related to government. Although the BCUC operates as a fully arm's-length regulator, it's just that part of the standard wasn't adopted because of the unique circumstances here in B.C.

S. Chandra Herbert: Just to follow up on that, my concern here — and maybe it's not well placed, but I'd be interested in your feedback — is that we've seen the B.C. government do things like require smart meters to go through without, in my view, a proper review from the BCUC. That obviously creates a large cost. We've seen that with other projects that the government has wanted to see go through without that full review and independence of the BCUC.

We've got them controlling Hydro. We've got them controlling what goes ahead on the capital side for something like a smart meter program without that review of BCUC. I guess that's where the conflict of interest could come in. I'm wondering if the Auditor might be able to help me understand that a little bit better — what that could mean, what the results of that could be — and if the comptroller might want to respond around the fully arm's-length BCUC when, in fact, government has directed it to do things.

J. Doyle: The Utilities Commission in doing its work operates as a semi-judicial process. We have not looked at what they do or how they do things, and so I can't make any observations or comments on the intricacies of how they go through what they do, although I've read through and listened to some of the hearings.

My concern, I suppose, on the face of it, and standing back several feet away from the situation, would be the following. The Utilities Commission is part of the government reporting entity, which, by definition, means that it's controlled by government. What I've noticed is that government has excised certain things from the commission, but I've seen no evidence that they've directed the commission to do anything. So if you like, there's a big difference between those two.

[1355]

I don't really know the full nature of the relationship between the Utilities Commission and government, and B.C. Hydro and government, to answer the question you've got fully. That would take some investigation, which we have not done and, I would say, would be very difficult to do as well.

R. Hawes: Mr. Gentner talked about Black Friday and red something. I guess I'm going to just talk about dark decade. Just as an explanation....

B. Ralston (Chair): This is in aid of your non-partisan comments previously?

R. Hawes: Exactly. Precisely. I've heard a few partisan things about nearing an election, etc.

B. Ralston (Chair): So you're talking about the present decade, then, or...?

R. Hawes: First, when we look at the graph here with the rate-regulated versus non-rate-regulated and how, as MLA Herbert said, they flipped.... I'm just going to go from my own memory, and then maybe I could get some confirmation if memory is correct.

During the 1990s, as I recall, there was no capital investment and investment in maintenance on things like transmission lines. It just wasn't conducted. Hydro paid nothing for maintenance. There was no capital investment.

In fact, in 2000-2001 we certainly found, if my memory is correct, that the transmission infrastructure was in shockingly bad condition and required very substantive investment. I would suggest that in the last six or eight years the investment in B.C. Hydro is probably the highest that it's ever been in the history of B.C. Hydro, with maybe the exception of when the big dams were built back under Wacky Bennett. I think that's a big part of the explanation for that flip, because those investments, it seems pretty clear to me, would be investments that are going to result in energy savings down the road.

I want to just use one example. I know that in my riding, where I live, there's the better part of a billion dollars going to be spent very quickly on the restructuring of the dam at Ruskin. It has to be done because it's probably not earthquake-safe. It's going to result — that investment — as I understand it, in about a 10 percent increase in the amount of power that's realized. So there will be a payback on the investment.

Now, it's not going to happen over a year or two years or five years. That size of an investment goes over a fairly lengthy period of time. The benefits of that aren't going to be seen, necessarily, by me. It'll be by my kids, down the road. So it just seems to me to make some sense to defer that off. Those who are going to benefit are the ones who are actually.... That's when the payback is going to come.

I also seem to recall a rate freeze that happened in the 1990s. The rate freeze was done for political reasons — no other reason. In fact, Hydro was moved by the previous government out of the BCUC altogether, so there was no oversight at all. It seems a little strange that those members would be talking about BCUC when we know that they didn't like what BCUC was doing and a rate freeze probably wouldn't have been in the cards. The politics of it couldn't have been attained without getting rid of BCUC.

Interjections.

R. Hawes: I guess I'll go down to my question. Now I'll go to my question. I'm sort of astounded when, first, the CFO, Charles.... You weren't consulted.

I find that a little strange when there's an audit going on — for which, I'm assuming, you know, there's an awful of work and an awful lot of contact — that the CFO wasn't part of that discussion. I find it a little bit strange. I'm not going to get into who said what. You've said that you weren't asked and the senior staff weren't asked for a plan. The Auditor is saying that they did look for a plan.

My question will be this. Do you have a plan for how this money is going to get paid back? If so, if that's provided now to the Auditor, is he quite prepared to say: "Okay, I'm going to go through this, and it makes sense"?

B. Ralston (Chair): It sounds like a question to you, Mr. Reid.

[1400]

C. Reid: I think the answer is that we could provide a plan about all our accounts, and what we're doing, to the Auditor General. Whether he would accept the logic and rationale is entirely up to him.

I just want to correct one thing. We talked about this plan — and he said, she said. I was talking about throughout the process. We started this review in the

spring of last year, all the way up to about two weeks before the report was issued. All during that time there was very little conversation with any of the B.C. Hydro staff. I think I had one initial meeting in the spring with two of the Auditor General's staff, and then I had one phone call a month or two later, and that was it. In the final couple of weeks, yes. The Auditor General gave us the report to comment on. We made a number of recommendations to the Auditor General on suggestions to what we felt would be to improve the report. Many of those weren't accepted, but we did make that.

I think it's important that.... Again, if we talk about your example of Ruskin and investments, I think it is.... Okay, it's not exactly the same. I get that. From an accounting point of view, Ruskin is different than capital-like, but it's the same principle. We really believe that the benefits will accrue, like you say, to your kids and grandkids and so on for these expenditures.

The problem that you run into with these things is that this could be a very, very long time. We have some amounts in our deferral accounts today that won't be recovered from ratepayers, probably, for 40 years. Now, is that terrible? Well, it isn't in the case of Ruskin. So is it in this case? Well, we think not, but certainly, we can provide all that information to the Auditor General.

R. Hawes: What's my memory of the 1990s — the lack of investment? Am I correct, or am I off base there?

C. Reid: I think the history of the '90s, again — I wasn't around B.C. Hydro at the time; it's what I've been told — was that there was minimal capital investment. Mostly it was just a break-fix kind of maintenance on capital. Something would break; we'd fix it. But there wasn't a plan to regenerate what we're talking about — refurbish the system like we're doing today. So that was really the issue. One could argue that by a lack of investment for a decade, that has put a lot of burden on the future in terms of investment, and we're playing catch-up mode, to a large degree.

J. Doyle: If there's a capital project, the accounting standards are more than adequate to cope with the accumulation of those expenses — placing them into tangible assets, non-current assets, and then to have them amortized once the work has been done. There is plenty of structure around how that works at the moment. Whilst you were talking, I was thinking: that isn't a regulatory account that you're talking about. That's an asset account that you're talking about.

The issue here isn't about the assets that B.C. Hydro has. Well, it is about assets, but it's about the assets that have been generated and created by the rate-regulation process. So if you're going to go and spend money on new transmission lines, new anything, that's the capital program. It's dealt with quite appropriately under the

accounting standards, and it's got nothing to do with the rate regulation.

The second thing is about the conduct of the audit. A lot of the information we needed for this actually came because we already had access to a lot of the documentation. We were actually using published information to present a report to consider how rate regulation impacted the operations of B.C. Hydro.

I'm glad to hear it was confirmed that there were lots of discussions, because I still haven't got the plan. I don't want to put you.... I'm already off your Christmas card list, but I would have thought that if there was a plan, I would have it in my hand, because it would be very important for me to stand up at some point when we were talking publicly and say: "I have received the plan. I've had a look at it. I understand it. I can take that recommendation off as being completely dealt with." Whereas, at the moment, what we've got to do now is wait until the follow-up report before I can actually get some feedback on what that plan actually is.

The issue that I have in my mind is: how is this block of money going to be dealt with over the next period of time? The government report was silent on it, other than to express concern. The slides that I recall coming up here express concerns about the quantum of the report, and I didn't see anywhere: "Here's the plan, and here we have how we're going to deal with it."

[1405]

I saw lots of ideas about individual accounts. I think I heard that. I've now heard that some of them are going to take 40 years before they come out. Okay, that's good. So where's the plan?

Now, whilst we're talking about this, I just want to emphasize one thing. The actual recommendation is not directed at B.C. Hydro. If I recall correctly, the recommendation is to the government. Where's the plan? Do you have the plan? Do you know what's going to be happening? That is the question I'm asking. I've not got any response in regard to satisfying me that there is a plan, which doesn't mean to say I'm disagreeing with you or calling you anything. I just haven't seen the plan, and I still haven't seen the plan.

B. Ralston (Chair): Thanks very much. I had myself next on the list. I wanted to ask one more technical question of Mr. MacLaren and Mr. Reid.

You mentioned that one of the capital-like accounts is smart meters and infrastructure. I had understood, under the Clean Energy Act, that the smart meter program, the billion-dollar program, was excluded from BCUC review. Is it that the smart meter plan is excluded — the business plan, if there is one — and this account is included, or was that a misstatement? I didn't really understand.

L. MacLaren: The Clean Energy Act exempted the smart metering and infrastructure program from the

requirements to secure a certificate of public convenience and necessity, called a CPCN. But the costs of the smart metering initiative and the benefits that flow to ratepayers will be taken through one of these accounts, which is, I believe, the subject of an application by B.C. Hydro in those revenue requirements.

C. Reid: Just for clarity on that. With the smart metering program, and actually with other exempt projects that we have within the BCUC, the approval of the project itself, like in the case of smart metering, was exempted, but not the prudence review of the actual spending of the dollars. That still occurs with all of these exempted accounts.

We still have to — for all of these accounts, for all of this expenditure — go back through a full regulatory process, describe what money we spent, the benefits we achieved and all of that. That is still there, so there still is that rigour and transparency around all that. That is yet to come in the case of the smart metering process. That will likely all occur in the next filing that will be in fiscal '15.

B. Ralston (Chair): So the same comments would apply to the capital-like account of Site C? Similarly, as I recall, it was under the Clean Energy Act. It was exempted from the same application process before the regulator. Isn't that right?

C. Reid: That's exactly right, except that the timing would be a little different on that. In the case of Site C, you'll find a couple of things that will happen. One is that once we do get an approval that we have a real project, then very likely we won't be putting more dollars into a regulatory account. We'll be putting dollars into a capital account, because we actually have a real project now to apply the dollars to.

We may still have some balance in these regulatory accounts that relates to prefeasibility studies and other costs that have to be then determined about what the recovery period is. But you won't see, for example, \$8 billion flowing into a regulatory account for Site C before it's built.

B. Ralston (Chair): So then, just to conclude on that, the Site C account that's mentioned and forecast to go to half a billion, \$565 million, in 2016 — the prudence of setting that aside is included within the jurisdiction of the rate application before the BCUC? Is that what you're saying?

C. Reid: The prudence of that spend will be determined once we go back for recovery and rates for Site C, which may be many years from now. That will not be part of a rate hearing in the near term but more in the longer term.

B. Ralston (Chair): Am I to understand that the wisdom, or not, of creating this regulatory account using the rate-regulated accounting principles is not at the present time being scrutinized by BCUC?

[1410]

C. Reid: The current spend on that we're reporting through to the BCUC, but they're not making any decisions or determinations based on that because we're not actually asking the commission to rule on the recovery and rates for the dollars.

L. MacLaren: Perhaps if I could just clarify, Mr. Chair. The commission has approved this deferral account, for it to exist — it approved it in 2006 — to accumulate these costs up to the point where a decision will be made whether or not to proceed with the project.

B. Ralston (Chair): Then I had a further question to Mr. Doyle. You mentioned the lack of a plan and the dollar value of these deferral accounts capping out at over \$5 billion in 2016. In your mind, what are the alternatives that exist to deal with this issue, in terms of a plan?

There are some words here on the final slide on page 5 about reducing balances over time and matching costs to beneficiaries. What are the alternatives? Some have suggested that a rate increase would be one way to deal with it, a reduction-of-capital plan, a cash infusion by the government. What is the range of alternatives available, in your mind, to deal with this issue?

J. Doyle: I did, in the body of the report, suggest that there were possibly three scenarios going forward. The three are on pages 13 and 14, if members wanted to read them. This was based on the assumption that the rate-regulated accounts do grow to \$5 billion and then they continue.

It's assuming, as we go forward, that these accounts continue to operate the way that they've operated in the past. "So what's the choice?" is the question. It's not necessarily my plan of action for the future. It's just: what's the choice?

There are only three. One is rate adjustments. One is operating efficiencies, and my guess is it's going to be very hard to squeeze that quantum of operational efficiencies in. The third is to receive a large infusion of cash, which you use, basically, to ride out these particular entries so that you don't have to rely upon tariffs to collect it. I can't think of another option that you would use.

Basically, the way that this is said at the moment is that there's a figure which is called an asset, which is in the balance sheet. The theory is that over time, whatever the time period is...

We'll just make it relatively straightforward. A small part of that will be put into the operating statement as an

expense as you go forward, and that expense is going to be matched against the income that's received in regard to rates and commercial operations. By netting it off, you basically draw down, or you wipe out, the amount that's been put on the balance sheet, and you match it against the future income streams, which is the point that's been made.

It sounds to me like that's going to take a very long time, because I think revenue is about \$3.7 billion plus commercial activities, so expenditure is quite significant. The interest payment is going up because of the capital investments that are occurring at the moment. There's not a huge profit that I can see, going forward. If there was a huge profit, I just might point out that that means the rates are too high, because basically, you're making a profit out of selling a product to people who own the company — doesn't make sense to me, either.

There are some issues going forward about how the financial management of this actually works. That is where I am confused — that I don't understand. That's the basis of the recommendation. "Please explain what's going to happen to this stuff as we go forward." To date I'm still not sure.

B. Ralston (Chair): Mr. Reid or Mr. MacLaren, did you have any further comment?

C. Reid: Well, I think the Auditor General makes some very good points, so I'm really not trying to argue with him...

B. Ralston (Chair): Well, we encourage a healthy debate here.

C. Reid: ...because we do respect the Office of the Auditor General and all that they do. We try to work closely with them, just like we do with our external auditors and so on.

[1415]

I think the issue is that yes, these are large amounts of money. However, part of the structure — why we use these accounts — is that they will be recovered from ratepayers over time. As I mentioned earlier, some will be recovered in a short period of time, and some will take much longer. We see nothing wrong with that. It actually is exactly what we do with all our other cost structures, whether it be capital or anything else. We recover that from ratepayers.

I don't think these accounts are going to keep growing from \$5 billion to \$10 billion and so on. I mean, structurally, they really can't. What you'll find is that...

You can use the Power Smart example. That program started four or five years ago, and it has been building. So we're amortizing that over ten to 15 years. It will reach a tipping point where the amortization in a year is greater than the expenditure in the year, and we'll recover that

more than enough to start paying down that balance over time. You'll see it rise, and you'll start to see it come down. That will take a number of years.

In terms of those accounts, they're based on the flow and the timing of that spend. It's probably going to take another five to ten years before that balance starts coming down. Nevertheless, it still will. It's still an accepted part of what ratepayers accept. I don't see any issue with that from a recovery point of view.

If we didn't believe and if the commission didn't believe that we could recover these regulatory accounts, they wouldn't allow us to have them. That's a basic premise behind how the Utilities Commission works. It's a basic premise around how our external auditors view this and approve our financial statements and the balances that are in there. They have to believe, based on the evidence, that all these amounts will be recovered in rates over time.

J. Doyle: We're not doing a tag. It's just an observation. So \$5 billion is a lot of money to recover from an operation that doesn't turn over more than \$4 billion a year. So we're talking about a really extended period, or something has got to give. The simple question from the report was: what's the plan? What's plan B? What's going to happen as we go forward? That's the question, which I still don't know.

As an auditor, I would look for an order from the Utilities Commission to say that these deferrals are allowed to take place, and that would be as far as I'd go. As long as I get that order then, as an auditor, they're in compliance with the standards — which they are. They've got approval from an external regulator, and because they can defer, it looks like they're still a going concern.

I'm going to have to sit down and talk with the auditors looking forward as to how far their projections have actually gone. But I would draw your attention to the fact that a financial audit opinion is limited. It does not look at prospective information, but it should consider going concern, as has been pointed out.

I don't know how far ahead they went in regard to it, and I don't know if they knew it was going up to \$5 billion. I assume that they did, because of the work they're doing under IFRS, and they can see the numbers shift and change. But I would suspect that the auditors would also be asking similar questions. It's just that their report doesn't come into the public arena.

V. Huntington: Given the complexity of this entire issue and almost black-and-white approach to this subject, I guess I'm left with three questions that perhaps the Auditor General could say make sense or not.

Does this issue hinge on how much is actually deferred and whether the future ratepayer — i.e., the source of intergenerational equity — can reasonably be

expected to pay the staggering debt load in the deferred accounts, and whether enough equity is being returned to B.C. Hydro to meet its business needs, or whether the government — the province, the powers that be — is demanding a dividend that Hydro can't afford to pay, and whether, given the economic future that we're looking at, Hydro as an entity can survive both the growing debt load and the dividend payments expected of it?

Are those fair questions?

[1420]

J. Doyle: Yeah, they are fair questions. The first thing I would say is that these shouldn't be characterized as debt. They're deferrals. Yes, money has been spent on some of them, if not the bulk of them, but not all of them. So it's not debt. It's an asset. It's a deferral.

The question about how much.... We did produce a graph which we put in the body of the report, which contrasted the way they'd gone from \$182 million to \$2.15 billion over a period of time. I think the graph showed the last five years. It's page 19. It's quite clear that the approach used within B.C. is markedly different.

If you then looked at size in relation to the organization of those deferral accounts, you also might be able to draw a conclusion that B.C. is different.

So in some respects, my concern has been around how they've been done, as opposed to whether they're allowed. They are allowed. I'll repeat it again. According to the standards, the Utilities Commission says yes, you can do this, and there's nothing wrong with it. It has been disclosed. It's an open.... It's out there for everyone to read that wanted to read it. So it's the quantum that's the issue.

The dividend. If you generate profits and you hold those profits, they become the cheapest source of funds for you for expansion of capital assets or reinvestment into capital assets. They give you lots of advantages.

What has happened for a very long time — I don't know how far back this goes because I haven't gone back forever, but I went back at least ten years — is that there has been, not every year but in most years, a dividend paid by Hydro. Certainly, in the last few years there has been a dividend paid by Hydro to the government.

I just want to put this in front of you as a thought. If you add the dividend to the water licensing fees, then basically what you've got is a payment that is being made out of the cash reserves of the entity to the province. If that money had been left within the entity, then it would be available, first of all, to invest and to reduce the amount of interest that they pay, because they could borrow less.

So what we've got is an entity that is making enough money that it can transfer a significant sum of money to the province at a time when it's deferring all these numbers. The way I'd look at that from a financial management point of view is that I'm not sure B.C. Hydro

can afford to continue to pay these dividends. All that's happening is that by transferring the money over, they can't invest in their capital assets because they haven't got any money.

They had \$27 million at the end of last year — so the beginning of the first quarter. They had roughly the same amount of cash at the end of the first quarter — roughly the same. I'm talking from memory. Yet in the interim period they had sold a lot of their product and got income. That's called operating income. They had invested in non-current assets, which is capital spend, and then they had borrowed. Basically, it looks, on the face of it, as if the borrowing paid for the dividend.

So what I see is a conversion of cash being transferred over and a replacement of what would normally be the province's taxpayer-supported debt by self-supporting debt in a different entity.

[1425]

I don't know a different way of explaining it. I'm sure there is another way, but I don't know it.

The third point was "going concern." I think that B.C. Hydro enjoys the backup. You know, the province can't afford for it to fail, and I don't think it is anywhere near in a failure.

The report that came out did make some comments about costs and efficiencies and those sorts of things. They're not unusual in the generating business — not unusual at all. I suspect that there's going to be some work that's going to be undertaken, which I have not considered or looked at, which is going to look at how to get efficiency and make it a leaner kind of organization and value for money.

So I don't have concerns around the going concern concept, per se, as things stand. I think it's still a viable organization. But I do think that it's got to be allowed to manage its own financial resources.

L. MacLaren: Just a couple of other comments in response.

The Auditor's report and the comparison with the other utilities was just on an absolute dollars basis. The government review on page 113 actually compares the regulatory assets to total assets as a percent, and that gives you a bit of a different picture. Actually, FortisBC, on that kind of measure, although it's a much smaller utility, has regulatory assets to total assets in a similar way.

The other thing I'd point out is that in the government review of B.C. Hydro it was recognized that a change in dividend policy could be desirable. The recommendation which the government has stated it accepted was as the economy improves, to have a look at capital structure and dividend policy with respect to B.C. Hydro.

V. Huntington: So if the recommendation is "as the economy improves," does that mean we can expect to see

further dividend withdrawals, if you can call them dividends, in the face of a poor economy as we go forward?

L. MacLaren: I think, if you look at B.C. Hydro's forecasts, they are not actually forecasting very large dividends over the next couple of years.

V. Huntington: That's nice to hear — sort of.

B. Ralston (Chair): I have four more speakers on the list, and I'm going to decide — I hope this is well received — to try to adjourn by three o'clock, notwithstanding we're set to go to 3:30.

G. Gentner: I just want to go back to the original letter from the Auditor General, the last paragraph on page 6, whereby we know what happened under the Budget Transparency and Accountability Act. The Treasury Board issued the Government Organization Accounting Standards Regulation, which throws the American accounting standard onto B.C. Hydro, thereby avoiding the transparency required under Canadian accounting standards — transparency that is essential to understanding B.C. Hydro's financial condition as a stand-alone enterprise.

Transparency can mean everything from contractual agreements of IPPs, etc. Could the Auditor General enlarge on that lack of transparency, the differences between the accounting systems?

J. Doyle: Under IFRS, which is quite different from the existing GAAP, there are, first of all, important transitional changes that are required. They're referenced in the slide before the one that was up there. There are pension costs, and there are also asset changes. So there's a lot of change in that, and the member may be aware that coming from Australia, I lived and breathed IFRS, or their version of it, for quite some time, particularly in the electricity industry.

So you've got some pretty big changes that are taking place. With the removal of rate regulation off the menu because it's not part of IFRS, the suggestion is that, in fact, you should be able to look at the face of the financial statements and get a picture. You should be able to read the story, if you like. You don't get this transfer of deferred expenses, called assets, onto the balance sheet. You actually see the result for a given financial year.

[1430]

If you like, this is a bit of a stretch of logic, but I'll just use it as an example. Based on the financial statements as they currently exist, I could argue that the rates are too high, because if \$443 million can be removed and the water licences fees can be done, this is a very profitable organization. That's both being paid to the province, who are the citizens, and the citizens own it. Therefore, you've got something like \$600 million or \$700 million

worth of expenses that you don't have to have or money that you don't have to pay out.

Really, the purpose of IFRS is to actually show what the true position is. It also brings in recognition of expenses, recognition of liabilities that may be occurring, recognition of revenue in a slightly different way than Canadian GAAP at the moment. It would provide a much clearer picture in regard to the transactions that are taking place within the entity. Now, if I'm not right, then 200-and-something-odd countries in the world are wrong with me. So I feel fairly comfortable about it.

S. Newton: All standards believe that they're going to be providing the best and most transparent information possible to their financial statement users. That would be the same as both an IFRS, PSAB in Canadian standards, as well as the U.S. standard, which includes rate regulation. Rate regulation is an actively debated topic right now. On both sides everybody is making the same statement — either not having rate regulated is the most transparent way to present this, or having rate regulated is the most transparent way to produce your financial statements.

It's so actively debated right now that the Canadian Securities Administrators, who regulate listed companies, have actually written to the International Accounting Standards Board and said that for filing purposes, they're going to allow listed companies in Canada to use rate-regulated accounting up to, I think, 2015 without having to file in the U.S. to get the U.S. GAAP treatment, recognizing that this debate is still active and ongoing. I appreciate that the perspectives will all say: "This perspective is more transparent."

I guess the trick with this particular issue being rate-regulated accounting is.... I don't think the issue is resolved. It's resolved as far as Canadians standards are saying it doesn't allow it, but I do expect that to change, and I do expect that at the international level it is actively debated.

Other countries have different systems for dealing with regulated entities. In North America it's a bit more of a pinch because of the way we deal with regulated utilities as compared to other countries. So an openly debated topic. I don't think there's a clear answer, but both sides will always say it is more transparent, and for very valid reasons.

S. Chandra Herbert: Just a quick question. Earlier the Auditor spoke about how in the past Hydro used to state its financial statements before deferrals and then with a follow-up statement of what it would look like if you.... Or maybe after deferrals. They had the two numbers broken out, but they don't do that anymore. It takes some work to try and figure out what the true financial picture is.

I'm just curious why Hydro made that choice and if the Auditor has any thoughts on the importance of that decision.

C. Yaremko: A couple of years ago B.C. Hydro implemented a new financial system. As part of that we looked at different ways of reporting. It's called the gross-versus-net method. In fact, B.C. Hydro, I think, was the only utility we could find in Canada, or perhaps North America, that used the method that we had been using, so we changed our method so that we would be consistent with other utilities in North America.

All the information, like we've said earlier, is available in the note. We actually say what our net income would be without regulatory accounting, in that note. So all the disclosure is still there. But we did it for consistency with our peer groups.

[1435]

J. Doyle: I understand the reason for the change. My observation is that there was a heightened level of disclosure on the face of the financial statements, not in the notes. To step back and to reduce that transparency seems, to me, to be a retrograde step.

K. Corrigan: I'm glad that the Auditor General mentioned, talked about, what the true impact was of the amount coming from B.C. Hydro in the form of a dividend — \$447 million in fiscal 2011, \$705 million in fiscal 2010.

One of the impacts that is noted in the report is that the deferral accounts have also had an impact on retained earnings. That's a concern because the report notes that retained earnings represent the financial resources that companies retain to reinvest in the business or pay down debt. They're increased by income and reduced by losses and the payment of dividends to shareholders.

So if you take a look at the graph that is in the report, what has happened as a result is that we have a serious reduction in retained earnings and, therefore, the ability to reinvest without deferral. It seems that the deferrals distort the true picture. As the report points out, if the trend continues as predicted in government's review, B.C. Hydro's financial statements will report negative equity under Canadian GAAP, potentially challenging the going concern assumption that underlies B.C. Hydro's financial reporting.

I know the Auditor General has said that there's not a real concern about this being a going concern because it's too valuable to the province. But one of the other effects is that we have an increased debt with B.C. Hydro.

I wonder if the Auditor General would like to comment any more or government would like to respond on this. Essentially, part of what's happening with government taking money out in the form of a dividend every year is that we're losing the ability, the flexibility, of B.C. Hydro to reinvest in the business or pay down the debt.

C. Reid: One point of clarity there. The dividend payments that B.C. Hydro makes to government on an

annual basis are a calculated number. They first start out by taking 85 percent of net income as a dividend, and 15 percent is, theoretically, retained.

However, there is also a prescription from the provincial government that says: "As long as your debt-to-equity ratio doesn't go worse than 80-20...." Today we're about 80-20. As was mentioned earlier, that's why the dividend payments over the next number of years will be dramatically reduced, because our debt-equity ratio otherwise would go beyond 80-20. So it is very unlikely that you'd get into a situation where you would be paying dividends to the point where you'd get into negative retained earnings.

J. van Dongen: First of all, I want to say that I appreciate both the spirit and the substance of the Auditor General's comments in his report. I do want to make a comment, first of all, related to the role of BCUC and then maybe ask a few questions about that in this instance.

[1440]

There has been some comment about the independence or perceived independence or lack of it made today. BCUC is not represented here today, and I think there has been a reference to the fact that it is a quasi-judicial tribunal. I appreciate the comments of the Auditor General that the basis of the review process under U.S. GAAP may be technically different than this tribunal in Canada, in B.C., but we have a lot of quasi-judicial tribunals set up under legislation in this province. We expect them to be independent, and generally speaking, they are independent.

I've seen more than one decision of BCUC go in a direction that wasn't favoured by government. I've also seen issues where the government has made a public submission to BCUC and the decision was different than what government would have liked to see. I just want to put it on the record that until proven otherwise, BCUC is an independent tribunal. Again, I say that with full respect for what, I believe, the Auditor General will say — that it is more independent under the U.S. system of how they're appointed or how they're established.

Having said that, I wanted to ask Charles Reid: am I correct in my understanding that these deferral accounts and these numbers have been approved by BCUC?

C. Reid: I think, as we mentioned earlier, we go to the BCUC when we want to create an account in the first place. We have an established process with the BCUC where they actually have well-defined principles about what they will allow in terms of a deferral account in the first place. These were determined a number of hearings ago. So we have these criteria. If we have an application for a deferral account that meets those criteria, the commission will normally allow us to initially create the account.

Then there's a whole series of processes where, depending upon the type of account, we will go back at either the next rate hearing or the following rate hearing and talk about, "Okay, now we have this money in these accounts. Here's what we want you to do, BCUC. We want you to approve us to recover these" — over five years, ten years, 20 years, whatever it is. The commission weighs in on that. Interveners weigh in on that. And they make a ruling.

Now, as you can imagine, when you have a number of accounts that are all sort of in motion at any one point in time, some have gone through the entire process all the way through, where the commission has approved them, and some are kind of midway through that process, where the account has been established and they are yet to go in front of the BCUC.

In this rate application that we filed yesterday, that debate will come up again. There will be some things in there that we'll be asking for Utilities Commission approval on. And you'll see a whole mixture of things that are approved, things that are halfway through, things that are three-quarters of the way through.

I think the key point is that we cannot sort of deal with those accounts until they get approved by the Utilities Commission. It's just a matter of timing.

J. van Dongen: Are you then able to incorporate these deferral accounts into financial statements before they're fully approved by BCUC?

C. Reid: Yes, we can. I mean, again, under our approach with our external auditors, they accept that this is a well-established process and that there'll be various things in motion. They accept that. Once the commission has approved the creation of the account — and we have a good expectation, a positive expectation through history, that these things will be approved — they accept those in our audited statements.

J. van Dongen: And you're satisfied that all of these accounts are consistent with the principles that have been established previously by BCUC. Is it possible for the committee to get a report on the status of these various accounts vis-à-vis BCUC?

L. MacLaren: All but four of the accounts have already been previously approved by the BCUC. Out of four accounts being applied for in this rate application, two of them are related to the transition to international standards that I referred to in my presentation. One is to smooth out the rate increase, the interim increase that's in place right now at 8 percent and the two following years at 3.9 and 3.9 percent — to accomplish that. The fourth one is a small account around some outsourcing implementation. All others subject to approval by the BCUC are all in place.

B. Ralston (Chair): Thanks. Mr. Doyle, you wanted to comment?

[1445]

J. Doyle: Just an observation and then a comment, if I may, Chair.

The observation is that it's the province that raised the issue of independence by the way that they constructed the regulation. They did not adopt the entire FASB 980; they only adopted the bit that excluded the independence of the regulator.

So it's actually the province that is saying that the regulator is not independent. But I did explain that as far as I could tell, they did their work independently. So I think it's the province itself that raised the issue. That was the first point.

J. van Dongen: I want to confirm that I understood that point. I hadn't heard that you had accepted, based on what you'd seen so far, that they were operating independently. That's why I made the point.

J. Doyle: The second one — it's come out. I wondered whether we should raise it or not. But I think it's good that it actually came out in the form of questioning about how these accounts actually get established in the first place and the fact that sometimes they are established before they are approved, type of process, which is in line.

The ones that were mentioned, particularly the two to do with IFRS — I understand how they're being created and everything else. They're out there. They've been shown in the government's report, but they haven't formally been approved at this stage. There is a bit of a process that they go through.

There were a couple that we detected, although they were small, that were not approved by BCUC. They were actually approved by the province, by a special directive. When I said, earlier on, that this is a complex area and we've tried to simplify it, we've simplified it to the point that the assumption is that everything is approved by BCUC. The reality is that there were a number that weren't, but they're not that big. So if we're going to get down to that kind of detail, there were a couple that, in fact, were actually approved by the province itself.

L. MacLaren: Perhaps just to respond to that. The initial direction coming out of the heritage contract proceeding earlier in the 2000s led to the direction to the BCUC to establish what was called the heritage deferral account to account for the variations and fluctuations and inflows to the heritage Hydro assets and also an account on trade income. That direction also included "and such other accounts as the commission may approve." There is, in fact, a commission order associated with those two accounts that were the subject of the direction.

B. Ralston (Chair): The direction emanates from the government.

L. MacLaren: That is correct.

B. Ralston (Chair): Unless there is any further comment from the Auditor General, I had Vicki next.

V. Huntington: My question has basically been answered, but I'll just put it on the record that I note that other regulatory accounts include the home purchase option plan, which I assume is the money spent for the purchase of lands and all the security costs and landscaping costs. Are renovation costs related to the purchase of homes in Tsawwassen when you put the transmission lines up? Is that correct?

C. Reid: That is correct. That particular account will capture the cost of the purchase of the homes and all the other ancillary costs, net of the sales proceeds of all those homes, and once that is finished, I think we have some tag-end costs to go in there. It's almost complete. I think all the homes are sold. Whatever the residual is in that account will be put forward in the next revenue requirement application, asking the commission for a recovery period of those amounts to bill against all ratepayers.

V. Huntington: Can you tell me what the total cost was in that account?

C. Reid: I'm going by memory. Perhaps....

V. Huntington: That's all right. If you don't have it here, that's fine.

B. Ralston (Chair): If you like, you could report to the Clerk, and we could circulate it later, if that's more convenient.

V. Huntington: That was an OIC direction, wasn't it?

L. MacLaren: That is correct.

B. Ralston (Chair): Mr. MacLaren is just confirming that that statement is correct.

That concludes the questioners. With the leave of the committee, rather than continue to our final report, I'm going to suggest that we wrap up. There are a few very brief business matters here before we adjourn. So if I could move to any other business....

[1450]

I want to thank the contributors and participants on the response to the reports and thank the Auditor General. My apologies to Mr. Macdonell on the third report, but we'll get back to it.

Other Business

B. Ralston (Chair): I just want to report briefly on the in-camera session that we spoke of in the last meeting. I did convene an in-camera session to receive a report from the Auditor General on the financial statement audit coverage plan. There were a number of members present who are recorded in the minutes. The discussion concerned matters that are more properly dealt with in camera — a meeting of about 45 minutes or so. Members' questions were answered, and I think the audit coverage plan will proceed forward on that basis.

The only other thing I wanted to....

I believe the Clerk has an announcement.

K. Ryan-Lloyd (Deputy Clerk and Clerk of Committees): I just want to advise members of a visit of a delegation

from Eastern Cape Provincial Legislature in South Africa, the select Standing Committee on Public Accounts, who will be visiting the Legislature here during the week of January 30, in about six weeks' time. I'll keep members up to date.

We hope to organize a series of informal meetings or perhaps a luncheon. I know that they would have an interest in observing the deliberations of this committee, should it be sitting during that week. So I will be in touch.

B. Ralston (Chair): Just before we adjourn there may be one matter further.

Okay. With that, we're adjourned.

The committee adjourned at 2:52 p.m.

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