Financial Review of BC Parks' Front Country Services Delivery Contractors

BC Parks, Ministry of Environment

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March 2012

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Executive Summary

We were asked by the Parks and Protected Areas Division (BC Parks), of the Ministry of Environment to conduct financial reviews of a number of selected Park Facility Operators (PFOs), and provide recommendations relating to PFO performance and the requirements of the agreements. We also participated in the concurrent review of a number of aspects of the arrangements with PFOs. We completed financial reviews of eight PFOs, from whom we received a high level of cooperation.

Requirements and PFO Performance

Our assessment of PFO performance largely addressed compliance with the agreements, but also included aspects of consistency with accepted business practices.

Compliance with respect to financial reporting was generally quite good, while we had more concerns with accounting systems and with cost accuracy and reasonableness, and particularly with revenue systems and controls. Some did not report actual expenditure numbers, but reported costs using estimates that were close to the budgeted numbers. We also noted a few examples of personal expenses and costs unrelated to the bundle business.

The financial reporting requirements in place are quite sound, and with clarification and moderate revision, will provide a good base for assurance and potential analysis. Where requirements were less clear, they contributed to a lower level of PFO compliance performance. We have made recommendations for clarification of financial reporting requirements, including an income statement template for each bundle at March 31, revisions to the template to facilitate comparison between bundles, company financial statements at the PFO company's year end, and the elimination of roll-forward requirements.

We observed weaknesses in revenue controls, which results in increased risk of revenue loss and reduced accuracy of reported revenue. Only four of eight PFOs reconciled revenue in attendance reports to cash receipts. In our view, there is room for BC Parks to consider imposing the form of revenue collection for certain parks, provide further guidance on the use and control of McBees and other revenue systems, on both daily revenue reconciliation (cash out sheets) and periodic reconciliation of reported revenue to cash deposits; and on the benefits of revenue controls; and to impose a requirement for the timeliness of revenue deposits.

We have also made recommendations concerning the standard of accounting systems, the reporting of actual costs, including cost certification, the use of asset registers and the reasonableness of depreciation, and the project cost/value estimation and reporting of preventative maintenance, including the use of implicit profit in estimates.

Use of PFO Review Information

This review has provided Parks with knowledge of the accuracy and reasonableness of reported PFO costs. In all cases, we were able to determine if the reported costs were real, meaning that they were actual costs per the accounting records, related to operations under the agreement, and any allocations of common costs were reasonable. We were also in certain cases able to identify whether the costs are necessary (and reasonable). Both these elements are part of the question of value received.

The information obtained during our review has provided the opportunity to build a cost model, leveraging information obtained in the analysis of reported information and comparison to the financial results of other PFOs, for use in mid-term negotiations or as an informed basis of comparison in the tender cycle.

This process has inevitably included identification of the relative profitability of bundle operations, which has brought with it some associated risks, and responsibilities. There are both contract law and privacy issues associated with the use and control of such information on PFO profitability. PFOs whose bids have been accepted are entitled to maintain the level of profit implicit in the accepted bid during the term of the agreement. And so, with respect to mid-term negotiations, it would appear to us that the implicit profit should be maintained for the existing elements of the agreement, but there is perhaps an open question for new and changed elements. This issue warrants obtaining legal advice. Discipline is therefore required, when attempting to realize savings in such three year negotiations.

Nature and Form of Agreement

There are significant constraints to major investments by PFOs, including limited revenue potential, particularly for smaller parks, and with respect to what is often only a two month summer opportunity. Investment potential has been cited by PFOs to support the case for longer term agreements, but we are aware of very limited investment having been made. In our view, major PFO investments are very unlikely for most parks.

For that reason, we view the PFO relationship as essentially a revenue collection and maintenance services contract, for which a five year term is appropriate. The use of five year agreements would in most cases provide for more competition, and reduces the need for the mid-term re-negotiation, which as noted above could be problematic. It is worth retaining the ten year term, and/or five year extension option for those rare situations in which additional investment was proposed in the tender process.

PFO s are now able to generate other revenue from additional services provided to park users, but which is specifically excluded from the operations under the agreement. The separation of other revenue and the restriction of access to such information are odd as the revenue would not exist without the basic operations under the agreement. An additional problem is that most PFOs are not removing all the costs connected to such revenue from the park maintenance costs attributable to Parks. In our view, it would make sense to merge such other revenue back into the main agreement. As a minimum, there would be a need to clarify the rules around cost attribution, and obtain understanding of the revenue amounts involved.

A. Introduction

A.1. Background

We were asked by the Parks and Protected Areas Division (BC Parks), of the Ministry of Environment to conduct financial reviews of a number of selected Park Facility Operators (PFOs), and provide recommendations relating to PFO performance and the requirements of the agreements. We were also asked to participate in the concurrent review of a number of aspects of the arrangements with PFOs, such as the form and term of agreements and the management of preventative maintenance activity.

PFOs provide visitor services, including revenue collection and campsite maintenance, in approximately 250 parks, most of which are grouped into approximately 30 bundles that are operated by PFOs following public tender processes.

The aim of the financial reviews of PFOs was to enable BC Parks ("Parks") to obtain a better understanding of campsite maintenance costs and PFO practices under the agreements, to provide Parks with assurance as to value, in keeping with its commitment to managing a world-class provincial park system, and to provide PFOs with the opportunity to demonstrate and where necessary improve their financial reporting performance.

Financial reviews of eight park facility operators were conducted: - six in February and March 2011 and two in October 2011 and February 2012. We issued separate reports for each of the reviews.

A.2. Scope and Approach

The review of each PFO consisted primarily of enquiry, analytical procedures and discussion of the information provided by the PFOs. The key purpose of each review was to determine whether or not the revenue and expenditure information reported in the annual financial report submitted to Parks agreed to the accounting records. We completed an overview of accounting records for revenue and expenditures, and of the reporting process. Our review involved limited examination of expenditure documentation, and limited verification of revenue records, and a preliminary assessment of compliance with the financial requirements of the agreement (as modified through amendments). We visited seven of the PFO's and conducted one of the PFO reviews remotely in order to ascertain the practicality of conducting financial reviews in such a manner.

We assessed whether PFOs were meeting the main requirements of the agreements, as they relate to financial management and reporting, and whether they employed accounting practices that are generally recognized for businesses of similar scale and scope.

Our review involved limited examination, and we did not perform an audit of PFO financial information. The extent of review was directed at meeting the specific needs of BC Parks in its ongoing relationships with the PFOs, and so we would caution any reader that the degree of reliance to be placed on each of our reports addressing PFO financial reviews should be limited.

We received a high level of cooperation from PFOs during the review process.

During the assignment, we contributed to discussion and development of other program matters, in particular discussions on preventative maintenance and the form and term of agreements. We also developed an approach to the analysis of PFO financial results, including a risk/screening model for PFO review selection or focus in negotiations.

We have organized our findings into six sections: the highlights of PFO performance, the benefits of PFO reviews, financial reporting requirements, revenue requirements, accounting and asset requirements, and the nature and form of agreements.

B. Results and Recommendations

1. Highlights of PFO Performance Under Agreements

For the purposes of this report, we have summarized performance and compliance into five areas: financial reporting; accuracy and reasonableness of costs; adequacy of accounting systems; revenue reporting, systems and controls; and other financial aspects. Our findings on performance deal in most cases with compliance with specific requirements of the agreement, but in some cases address generally accepted business standards that may not be specified in the agreements.

We have presented our recommendations on these matters following our discussion of suggested changes to requirements in section 3.

1.1 Financial Reporting

The level of compliance with financial reporting requirements was good overall. Almost all required financial information was submitted:

- 7 of 8 PFOs completed Parks' income statement template
- All 8 submitted an income statement, three combined with other bundles or business operations, which caused some difficulty in isolating costs for each bundle
- All 8 submitted a balance sheet – again 3 were combined with other operations.

The income statements provided were generally in the same format as Parks' Financial Statement template, with some variations in the categories. Some additional categories were added by PFOs, such as corporate income taxes, and some categories were not filled out, such as off-season costs. Some of the balance sheets were out of balance (assets do not equal liabilities/equity) and some were incomplete, and so reliance could not be placed on them.

Our review also identified that the Statement of Changes in Financial Position (or Statement of Cash Flow etc) was not provided by many of the PFOs. We provide our comments on the continued need for this statement in section 3.

1.2 Accuracy and Reasonableness of Costs

We examined whether reported financial information was supported by PFOs' accounting records, and properly represented the operations under the (bundle) agreements.

We found that reported expenditures were not always supported by invoices and other records. In 2 cases, PFOs had used estimates rather than actual costs in some of the expenditure categories, thereby understating their profit in reported information. In another case, the PFO had personal expenses and some costs not related to the parks business in the financial report. The reporting of preventative maintenance has also caused some difficulty (see section 5).

5 PFOs made allocations of management and administrative costs, which is applicable where they operate other businesses or bundles. In all cases, these allocations were found to be reasonable.

However, only 2 of 8 PFOs fully separated the costs associated with other revenue, and charged the costs to that revenue. This means that the PFO enjoys the revenue that is outside the agreement, but Parks is carrying the costs associated with that revenue. In most cases, direct costs, such as firewood, ice and confectionary were charged against the revenue, but in only 2 cases, the wages were charged against the revenue.

6 PFOs thereby under-stated their profit under the agreements. This often involved minor amounts, but for some of the larger PFOs, this is not the case, and in most cases Parks simply does not know. And if PFOs chose not to provide access to this information, as they are generally entitled to do under the agreements, Parks would not know the extent of the exposure. Issues relating to other revenue are further discussed in Section 4.

1.3 Accounting Systems

The PFO agreements require that PFOs "must keep books and records with respect to your operations under this Agreement". The term "books and records" is rarely further described in legal agreements. We took the view that this should include a general ledger, with supporting systems and related accounts. "Operations under the agreement", in our view, is a clear requirement for separation of the accounts for the bundle in question from other bundles or operations that the PFO may have.

5 of 8 PFOs operated properly functioning accounting systems. 6 PFOs used accounting software, with a general ledger and sub-ledgers, based on a chart of accounts with account categories for different cost types and in sufficient detail. However, one of these did not fully separate distinct bundles in the accounting records.

2 of the 8 PFOs used excel as the accounting records, which in most cases is not suitable for this type and scale of operation with large volumes of expenditure transactions.

Accounting systems are important because they are the official record of financial operations, with recording processes and controls that provide for accurate financial reporting.

In all cases, PFOs had appropriate payroll systems in place, including timesheets.

1.4 Revenue Reporting, Systems and Controls

Performance with respect to revenue reporting was good, in that all 8 PFOs used the monthly revenue reporting template, and all 8 PFOs reported revenue by park by month. There were a few basic deficiencies, such as monthly attendance and revenue not being totalled in all cases, and a few cases of the park and year not being identified on the monthly attendance sheets. And in one case, it was not clear if the information is complete.

PFO performance in the operation of revenue systems and controls was generally the area of greatest concern.

All PFOs operated the basic revenue system of daily pick-up, with proper recording (mostly through use of McBees), and recording of revenue and attendance information. For a number of parks, the Discover Camping Reservation system is used during peak season.

In some cases, we observed the use of self-registration envelopes where we felt that McBees should have been used. We also observed weaknesses in the use and control of McBees, and in cash reconciliation and control, as described below. We were also made aware of an issue that resulted in the loss of cash and records for one park, which reduced our ability to complete our verification steps.

To better provide for completeness of revenue, it is worth Parks directing the use of particular systems, and minimum standards for the use of such systems.

<u>Revenue Recording</u>

In our limited sample, we observed instances with the following deficiencies, where improvement is required in order to achieve a properly functioning revenue system:

- Some completed McBee sheets were missing;
- Key information was sometimes missing, such as the name of the camper and vehicle information, or the park and year, and they were not all signed and dated;
- Some McBee sheets were not totalled or carried forward;
- Some pre-numbered McBee sheets were used out of order or could not be reconciled;
- In a number of cases, McBee sheets and other revenue records were not filed in an organized way;
- In a few cases, daily information did not agree to the summarized information on the monthly attendance report.

We also identified weaknesses with computerized revenue recording, and in balancing revenue to cash received.

<u>Revenue and Cash Control</u>

While some PFOs were following sound cash control practices, we observed a number of examples of the following deficiencies:

- Deposits not reconciled to (McBee or computerized) daily sheets by park;
- Cash-out sheets unclear, or unsigned and undated;
- No reconciliation/identification of cash withheld from deposits. Withholding cash from deposits for payment of expenses may be a common practice in remote areas. This is an acceptable practice as long as the reconciliation is performed before cash is removed for other purposes;
- Some deposits were not timely, exposing the PFO to increased risk of cash loss.

We also observed weaknesses in revenue controls, which results in increased risk of revenue loss and reduced accuracy of reported revenue. Only 4 of 8 PFOs reconciled revenue in attendance reports to cash receipts. This is a critical control. Those that operated this control tended to have other controls, but in 2 cases, the reconciliation showed that cash was a few per cent below reported revenue – amounts that should have been investigated.

Our recommendations with respect to revenue are presented in section 4.

1.5 Capital Equipment and Assets

Our review of capital assets focused on whether equipment and assets are appropriately capitalized, and whether depreciation is appropriately calculated and reasonable.

We found that 5 of 8 PFOs maintained records (ledger or list) of capital equipment at March 31, 2010, and another was in the process of implementing an equipment ledger. 2 PFOs did not have clear records.

4 PFOs reported correct amounts of depreciation, and 2 reported incorrect amounts. For the 2 PFOs with no records, we were unable to assess the depreciation charge, but they appear minimal.

1.6 General Financial Requirements

For the general regulatory requirements of agreements, the compliance level was high. All PFOs had the required levels of insurance, and were registered for HST and with Worksafe BC.

2. Benefits of PFO review process

2.1 BC Parks' Need for Information

Prior to the conduct of this review, Parks was exposed due to having insufficient knowledge of the accuracy and reasonableness of PFO costs. Parks had obtained some cost assurance from those tender situations with multiple bids, but had far less certainty following re-negotiations during a ten year agreement. It had also been many years since the parks were operated with own forces.

Parks needs to know if it is receiving value from its Frontcountry delivery services partners. We addressed this question in two parts. In all cases, we were able to determine if the reported costs were real (materially real, due to the limitations of review scope), meaning that they were actual costs per the accounting records, related to operations under the agreement, and any allocations of common costs were reasonable. We also provided information and assurance in certain instances on whether the costs are necessary (and reasonable).

This process has inevitably included identification of the relative profitability of bundle operations. Information on profitability brings with it some associated risks, and responsibilities. Consideration of the question of value received inevitably includes consideration of what constitutes a reasonable profit. (See section 2.2).

The information obtained during our review has provided the opportunity to build a cost model, leveraging information obtained in the analysis of reported information and comparison to the financial results of other PFOs. This model is described below.

2.2 Use of Information in Contract Management

Parks believes that it has the need and right to know:

- Whether costs reported are real and reasonable, which provides some assurance as to value received;
- What are the necessary and reasonable costs for each bundle, so it can enter the tender cycle with an informed base against which to compare bids received.

Parks has a particular interest in accurate and reasonable costs when the agreement involves a deficiency payment. While major deficiency payments are usually in major agreements, it is worth noting that these are not necessarily the most high risk agreements to review.

There are both contract law and privacy issues associated with the use and control of this information on PFO profitability. From a privacy perspective, its use needs to be properly controlled.

The additional financial information brings Parks knowledge that will enhance mid-term negotiations, but it also brings risks and responsibility. PFOs whose bids have been accepted are entitled to maintain the level of profit implicit in the accepted bid during the term of the agreement, but which is subject to renegotiation if the financial arrangements are opened up, which typically happens each three years. In such cases, it would appear to us that the implicit profit should be maintained for the existing elements of the agreement, but there is perhaps an open question for new and changed elements. This issue warrants obtaining legal advice.

Discipline is therefore required, when attempting to realize savings in such three year negotiations.

2.3 Cost Comparison Model

The Parks' campsite maintenance business is well defined with standard expenditure types, and while there are differences in cost amounts and cost/revenue relationships depending on the scale, region, length of season, and driving distances etc., we felt that there is an opportunity to gain financial intelligence through comparing key ratios between similar bundles. We therefore developed a prototype cost comparison model based in Excel.

Using the revised PFO income statement template, data on each bundle is entered into Excel, and cost relationships can be analyzed and compared. The preliminary points of analysis are:

- Wages as a percentage of revenue, and of revenue plus deficiency
- Operating costs as a percentage of revenue, and of revenue plus deficiency
- Each operating cost in relation to wages
- Administration costs in relation to operating costs
- Costs per campsite.

The costs should be compared amongst similar bundles (size, configuration, region), and used to formulate questions or areas of focus for the tender or renegotiation cycle. The costs can also be used to screen for selection of audit/review candidates.

In our view, in combination with the assurance obtained through the tender process (where there are multiple bids) and the audit/review cycle, the model can provide for a substantial level of assurance around PFO costs.

3. Financial Reporting Requirements

3.1 Introduction

PFO agreements have a requirement for delivery of financial statements within 30 days of the end of each operating year. They must be in accordance with Generally Accepted Accounting Principles (GAAP), and include a balance sheet and income statement, and a statement of changes in financial position. The financial statement must also reconcile with the revenue reported in the monthly attendance and revenue report template.

Parks also introduced a financial statement template in 2008 to 2009, which is required to be submitted within 30 days after completion of the operating year. This template presents detailed revenue and expenditure information, to form the basis of analysis and comparison to budget information presented in the Annual Operating Plans (AOPs).

Questions have been raised by PFOs about the need for, and use of, two sets of financial information. In our view, these requirements are sound, and with some clarification and some revisions, will provide a foundation for effective financial monitoring.

3.2 Clarify Financial Reporting Requirements

Parks has required the financial statements submitted to be as at March 31, to coincide with government's year end. This is a reasonable requirement for the financial statement template, which is effectively the income statement template, but is not reasonable for company financial statements, which are prepared for the PFOs' company year end. Many PFOs have other businesses with other requirements that may determine the company year end, and most will selected year-ends based on business cycles and will have established those year-ends for tax purposes.

It is our view that the requirements should be clarified to provide for:

- Income statement template for each bundle for 12 months ended March 31
- Financial statements for the operation (bundle) or company at the company's year-end.

3.3 Income statement

The income statement PFOs provided were generally in the same format as Parks' Financial Statement template, with some variations in the categories. PFOs included additional categories, such as corporate income taxes, and some categories were not filled out, such as off-season costs.

There is an opportunity to better understand service delivery costs and to provide for comparison between bundles through revision and clarification of a number of cost categories in the income statement template.

One example of this is owners' earnings. In some cases, we observed wages and salary paid to owners being grouped with employee wages and salaries. Owners' earnings can also be taken as salary, or profit, some of which may also eventually be paid as dividends. Guidance should be provided on owners' remuneration and its separation from employee wages or salaries. Wages and salaries of family members can be treated as employee payments where the rates are consistent with other employee rates.

This likely involves distinguishing between the following cost categories:

- Employee wages
- Employee management salaries
- Owner wages
- Owner salary & other earnings
- Profit.

Other suggested changes to cost categories include:

- Grouping of cost categories between campsite maintenance and vehicle costs, which will require separation of repairs and maintenance into two categories
- Move utilities expense from administration into operational expenses.

3.4 Balance Sheet

The requirement for a balance sheet does not appear to be well understood, and needs clarification.

One of these is the use of the balance sheet by Parks. The balance sheet relates to the financial position for all of a PFO's business activities. In many cases, this involves unrelated business operations or other bundles, and in such cases a balance sheet for just one bundle is difficult to produce and not very meaningful. Some PFOs reported having been requested to 'roll forward' their balance sheet from the company year-end to March 31. This again is a pointless exercise for a balance sheet.

The value of obtaining a balance sheet is that it provides Parks with the financial position of the PFO, providing information on the assets and liabilities of the PFO, and an indication of the operational viability and solvency of the PFO. The balance sheet is also used in the critical review of financial information in the tender process, and so comparison to subsequent balance sheets is a useful means of ongoing review of financial condition.

There is the potential to request very limited balance sheet information at March 31 to assist in financial analysis. The key element is total physical assets in the bundle – this can then be related to the depreciation being charged in the income statement template. The second element is bank and other loans – that can be related to the interest expense.

3.5 Statement of Changes in Financial Position

Our review identified that the Statement of Changes in Financial Position (or Statement of Cash Flow etc) was not provided by many of the PFOs. The requirement is not well understood by PFOs, one of whom interpreted this as a need for a letter from the bank dealing with financial well-being (solvency).

The statement is very complex to produce for partial operations such as a bundle, and provides little additional information beyond the income statement and balance sheet, in the context of what are largely cash businesses. Consequently, the Statement of Changes in Financial Position has limited usefulness and should no longer be a requirement.

3.6 Statement of Retained Earnings

The Statement of Retained Earnings forms part of a normal complete set of financial statements, and is useful because it shows the distribution of profits during the year, or after the year-end in subsequent statements. This information is useful to confirm income information provided in the income statement template. Dividends do not appear as a line item in the income statement template, because they are a distribution of profit.

3.7 Roll forward

In some cases, PFOs have been requested to 'roll forward' their financial statements to March 31 to coincide with government reporting and facilitate comparison to AOP budget information. Such roll forward can be onerous, and should not be necessary where the income statement template has been submitted as at March 31.

Comparison between the income statement template at March 31 and PFO company financial statements at the company year end should in most cases not be greatly affected as the bulk of operations will have taken place primarily during the summer months and be adequately contained within both statements, despite the different year ends. This would not be the case in the event of year ends between April and August, which would be unfortunate choices. This view also might not apply to PFOs which also have ski hill operations.

3.8 PFO Cost Certification

To ensure that PFOs report actual costs, the income statement template should be enhanced to include a signed statement from the PFO that all reported costs are actual costs that are supported by the accounting records. Ideally, this certification would be signed by a qualified accountant, or at a minimum by the owner.

3.9 Recommendations for PFO Reporting

We recommend that requirements be revised/clarified to the following:

- *Income statement template for each bundle for the 12 months ended March 31*
    - *PFOs must report actual costs (not estimates or budget amounts), and use all template categories*
    - *Template to include a signed certification by the PFO.*
- *Some revisions to template cost categories:*
    - *Distinguish vehicles maintenance from other maintenance, and establish vehicle cost and other maintenance cost sub-groups*
    - *Add categories to distinguish owner from employee remuneration*
    - *Move utilities from administration to operating costs*
    - Add *notation in the template for two balance sheet items – physical asset base and loans / bank balances (including overdrafts)*
- *Financial statements for the operation (bundle) or company at the company's year-end:*
    - *Financial statements to contain an income statement, balance sheet, and statement of retained earnings, and related notes*
    - *Statement of cash flow (or changes in financial position) not required (this is a departure from GAAP, that may need to be noted in the agreement)*

- *Roll forward requirement for financial statements (to March 31) not required.*

4. Revenue Requirements

4.1 Revenue Control and Accuracy

As discussed in section 1.4, we identified a number of weaknesses in revenue management. These included:

- The choice and operation of revenue systems, in that self registration envelopes were used where McBees were suitable;
- The use and control of McBees, in that they were different approaches to their completion;
- The reconciliation of revenue to cash, either through review of daily cash-out sheets and/or periodic reconciliation of revenue to cash deposits;
- The timeliness of deposits.

We also observed weaknesses in revenue controls, which results in increased risk of revenue loss and reduced accuracy of reported revenue. Only 4 of 8 PFOs reconciled revenue in attendance reports to cash receipts. This is a critical control. Those that operated this control tended to have other controls, such as the drive through or walk through (preferred) checking the currency (existence and sequence) of McBees, and occupancy rate tests.

We understand that Parks has been reluctant to impose particular systems and approaches onto PFOs, but the weaknesses were of sufficient concern to warrant introduction of requirements. PFO revenue loss is also a risk to Parks, with respect to the accuracy of reported revenue, PFO solvency/viability and the potential pressure in renegotiation. To better provide for completeness of revenue, it is worth Parks directing the use of particular systems, and minimum standards for the use of such systems.

Recommendations

We recommend that Parks:

- *Consider imposing the form of revenue collection for certain parks;*
- *Provide further guidance on the use and control of McBees and other revenue systems, and require that PFOs take training on each system;*
- *Provide guidance on both daily revenue reconciliation (cash out sheets) and periodic reconciliation of reported revenue to cash deposits;*
- *Provide guidance on revenue controls and their benefits;*
- *Impose a requirement for the timeliness of revenue deposits.*

4.2 Other Revenue

In providing the required services, PFOs are allowed to generate additional revenues that are closely linked to park operations. This includes firewood sales, concession revenues and equipment rentals. As recently negotiated, the PFOs are not required to provide any information to BC Parks about these revenues.

There are three types of costs related to the generation of the other revenues:

- The directly identifiable costs that can easily be separated from the delivery of services required for park operations, such as the purchased cost of the firewood sold in the park.
- The second cost type are those that increase the delivery costs of normal park operations, such as the transport to the parks of firewood in vehicles that are assigned and charged to park operations. These increase the related costs of gas and repairs.
- The third type are those costs that can be leveraged in the generation of other revenues but do not increase with the additional activity, such as the wages of park staff that collect money for the firewood sales, or are involved in concession sales.

We identified in our review work that the more identifiable costs, such as firewood purchases, were generally excluded from the costs submitted as part of the PFO financial statement template. However, we did not find any adjustments being made to the financial statement templates for the less identifiable costs that would relate to other revenues, mainly because of the complexities in identifying and calculating such adjustment amounts.

As there is not a simple or agreed means of identifying and segregating all of the costs for these other revenues, the exclusion of such revenues from the PFO financial statement template, and the inclusion of the related costs, understates PFO profit. In many cases, this additional revenue is minor, but for the larger destination parks, this may not be the case.

We provide our views on the validity of the separation of other revenue in section 6.3.

If other revenues continue to be excluded from PFO financial statement reporting, surrogate measures should be considered to estimate the amount of the less readily identifiable costs and make the adjustments to the information reported to Parks. This could be as simple as a percentage of the revenues being used as an estimate of the less readily identifiable costs, based on analysis of some sample revenues and costs.

<u>*Recommendation*</u>

- *If other revenues remain outside the agreement, consider surrogate measures to estimate the amount of the less readily identifiable costs related to other revenues and a requirement to make adjustments to reported financial information.*

5. Accounting and Asset Requirements

5.1 Accounting Systems

The PFO agreements require that PFOs "must keep books and records with respect to your operations under this Agreement". However, the term "books and records" is not further described in the agreements. In our view, it is necessary for PFOs to have properly functioning accounting systems, using accounting software, with a general ledger and sub-ledgers, based on a chart of accounts with account categories for different cost types and in sufficient detail to meet Parks' template needs. Spreadsheets (e.g. Excel) in most cases are not suitable as the accounting records for this type and scale of operation with large volumes of expenditure transactions.

Also, "Operations under the agreement", in our view, is a clear requirement for separation of the accounts for the bundle in question from other bundles or operations that the PFO may have, but these were not maintained in all cases.

In all cases, PFOs had appropriate payroll systems in place, including timesheets, which were generally linked to each park.

Recommendation

We recommend that Parks further define and clarify the requirements for accounting systems, and the requirement for financial reports for each bundle, being the operations under each agreement.

5.2 Capital Assets and Depreciation

Equipment Records and Depreciation

Most of PFOs reviewed maintained an asset and equipment register (sub-ledger or list). An asset register should be a requirement of the agreement. Assets should be depreciated (amortized) over the useful lives of the assets. Income tax rates are not always a suitable reflection of the useful lives for certain assets.

Other Business Operations

A number of the PFOs operate businesses in addition to their parks operations, and some of these are substantial. In such cases, PFOs may have common equipment that is used by, and therefore shared between, the operations. The costs of this shared equipment need to be allocated between the applicable operations. Depreciation, interest/financing costs, and repairs/maintenance are all potentially involved.

To ensure that the costs for common equipment are allocated appropriately, PFOs should allocate these costs based on the respective level of usage between the different businesses. This will likely involve tracking such costs separately from equipment that is dedicated to park operations.

Asset Base

A number of PFOs informed us that Parks had imposed a maximum limit on the capital asset base that could be used for calculating the amount of depreciation for the equipment used in parks operations. The rationale for such a limit is that Parks should not be paying for equipment not used or needed in parks operations.

This appears to be a reasonable approach to avoiding over-investment in capital assets and, where applicable, it should be formalized in the agreements. The level of the capital asset base should also be linked to the size of the park bundle.

Leases

We noted that a PFO can "bypass" the capital asset limit by leasing some of its equipment. Such leased assets should be considered as capital assets and subject to the capital asset base limits to ensure all PFOs are operating under the same rules.

Vehicle Repairs and Maintenance

In our review we identified there are no checks on the level of repairs and maintenance. Where a PFO's business model involves an older asset base rather than new or 'late model' vehicles and equipment, the costs of repairs and maintenance could be significantly higher than the combined depreciation and maintenance for a more modern asset base. Consequently, the repairs and maintenance categories should be considered along with depreciation when evaluating the reasonableness of equipment costs.

Acquisitions of minor equipment

The only control for weed whackers, chainsaws and other small equipment is the budgetary limit for the category. The cumulative investment in such acquisitions should be considered in evaluating the appropriateness of planned costs for this category.

Recommendations

We recommend that PFO agreements provide for the following requirements:

- *Asset registers, listing all assets used in parks operations, including the manufacturer, year of manufacture and year of acquisition, and depreciation rate;*
- *Depreciation rates reflecting the estimated useful lives of the assets;*
- *The costs (depreciation, repairs/maintenance, etc) of any equipment that is used in other business activities and parks operations be tracked and allocated based on respective usage;*
- *The limits on the asset base for park operations be established on the basis of park bundle size and confirmed in agreements;*
- *The cost of leased assets be subject to the asset base limit.*

We also recommend that:

- *The costs of equipment repairs and maintenance be considered with depreciation charges in evaluating the reasonableness of equipment charges*

- *The cumulative investment in small equipment, such as weed whackers and chainsaws, be considered in evaluating planned expenditures for this category.*

5.3 Preventative Maintenance

We participated with Parks' PRISM working group in the review of a number of issues involved with preventative maintenance. These include definition of the various maintenance and replacement work, and the budgeting, cost and profit components, tracking and reporting of preventative maintenance projects.

PMA definition

The definition of preventative maintenance has caused a number of problems in application. It has not adequately distinguished between replacement projects and certain ongoing maintenance items. We found variation in the types of preventative maintenance work included in the annual plans. It ranged from the normal repair and replacement of capital items to tree removal and included items that would generally be considered part of normal maintenance. Parks is in the process of developing new definitions of Repairs and Replacement that should adequately distinguish between the various maintenance types.

PFO Reporting

During our review, we observed considerable variation in the treatment of preventative maintenance in the annual financial statement templates submitted by PFOs. We saw reporting of:

- The agreed upon allocation amount for the year
- Non-wage related direct costs – (hard costs such as materials and supplies, with preventative maintenance wages remaining part of the regular wage cost)
- An amount that represents wages and direct costs and a profit component (to match market costs)
- The agreed upon allocation amount in addition to the actual costs of preventative maintenance included in other cost categories.

The variation in reporting shows that the rules are not clear and not well or consistently understood by PFOs and Parks' contract managers. It also has the potential for enabling PFOs to earn additional profits which are not easily identifiable.

Budget Allocation

Preventative maintenance has been established as a separate account from the regular PFO campsite operations, with allocation amounts agreed by Parks on an annual basis. PFOs can under-spend the budgeted amount, resulting in potential carry forward amounts. This has caused an uncertainty as to which amounts to report, and this requires clarification. The separate funding allocation means that the amounts spent should be reported and tracked differently, in order to account for carry forward amounts.

Reporting actual amounts for preventative maintenance in income statement templates is a less desirable option, as it can inflate profits in years the preventative maintenance costs are under budget and show a loss in years where carry-forward projects are completed in the current year.

This separate account presents a need for a separate preventative maintenance statement to be filed, reconciling movement in the account. The reconciliation takes the carry forward amount from the previous year, adds the amount of the current year preventative maintenance allocation, and deducts the amount of the completed preventative maintenance (accepted costs) during the year, arriving at the amount to be carried forward to the next year.

Cost Components and Value

In some cases, PFOs complete preventative maintenance projects using labour that is either paid at a day rate or expensed in regular operations. In such cases, incremental labour cost is a fiction, and paying based on project estimates therefore increases profit significantly as Parks is paying more than actual cost (can be paying 'paid labour' twice).

Where PFOs keep the maintenance wage cost in general labour costs, it makes more room for maintenance project profit. If they allocate wage cost to maintenance project costs, then this reduces the general wage cost.

These issues have created friction in the management of maintenance projects, which involves the issue of Parks obtaining value for maintenance projects, including the question of PFO profit on such work. One option would be to approve projects based on incremental cost, in which just incremental (wage and other) costs would be paid. PFOs would be required to prove that the wage cost in such projects is incremental to "normal" operations (through timesheets etc). This would likely be a disincentive for the PFO to do any such projects, as profit would now be based on only materials and equipment. There is the potential to base profit on an estimate that includes the labour component.

Parks' acceptance of estimates needs to be based on full disclosure of all costs, and an understanding of profit. The market place can be used as a basis for value comparison, but continued use of the market for cost comparison cannot be sustained unless such enquiries result in some work being awarded to third parties.

We found PFOs to be quite consistent in their view that the reported amounts should include contracted costs, wages, materials and supplies and a profit component. We concur with this view.

Recommendations

We recommend that:

- *Parks establish the agreed upon allocation for the year as the amount included for preventative maintenance in the budget and the only amount reported in the PFO financial statement template;*

- *A separate preventative maintenance statement be filed that reconciles movement in the account;*
- *All applicable costs and an agreed-to profit amount are included in project estimates and accepted project amounts;*
- *Parks introduce a preventative maintenance certification, in which PFOs sign-off that costs such as wages, supplies, etc for preventative maintenance are limited to the preventative maintenance category and not duplicated in other financial statement template categories;*

6. The Nature and Form of Agreements

A number of closely related issues are involved in any consideration of the form and term of agreements. These include the nature of the services, the potential for additional services and revenue, the potential for investment and the term of agreement that would need to be in place, the natural incentives created by the budget and potential re-negotiation processes involved in the arrangements. There are also the questions of other revenue and bundle configuration.

6.1 Incentives and Profit

The PFO agreements generally have a 10 year term, but provide for re-negotiation, at three year intervals, in the event of certain changes in circumstances.

PFOs have a natural incentive to beat the agreed budget and increase profit, subject to maintaining the standards required under the agreement. They might therefore be concerned about Parks' use of information that shows their increased profit.

There is therefore a disincentive to report actual costs and/or to achieve costs that are lower than projected, particularly in the context of the three-year budget renegotiation that is used to establish payments to PFOs.

In our review we observed reported financial information that was intended to "mimic" the budget amounts. While most PFOs reported actual costs, or near to them, in two cases PFOs used estimates and we identified that the actual costs were significantly lower than the amounts reported.

Some PFOs combined bundle information with other bundles or operations, which obscures bundle results. We suspect the cause is fear that Parks will attempt to capture some of the profit in re-negotiation. The contract renegotiation format also provides a disincentive for PFOs to reduce planned costs to below the budgeted amounts.

The reluctance to achieve or show costs lower than budgets will also affect future submissions of the three-year budget. The lower the actual costs reported to BC Parks, the higher the likelihood that PFOs will be required to use the lower costs in their budget submissions. Costs that subsequently prove to be higher than the reduced budget will likely not be recovered.

Consideration should be given to incentives that do not penalize PFOs that achieve costs that are below budgeted amounts. The latter could involve allowing PFOs to rely on cost ranges over the past three years as the basis for their submission of the three-year budgets.

Parks' contract managers are under budget pressure and this pressure is applied in any renegotiations. One of the problems in this is that they may not be aware of the profit or PFO earnings implicit in the agreement. Nor are they assisted by a government policy statement on what constitutes a reasonable profit, either generally or for these agreements.

While we have views as to the likely range of acceptable profit, Parks must be limited by the profit implicit in the accepted bids.

6.2 Investment

There are significant constraints to major investments by PFOs. These include limited revenue potential, particularly for smaller parks, and there might also be reluctance on the part of PFOs to enter bank loan arrangements that require personal assets as security. Some PFOs point also to what is often only a two month summer opportunity as a major barrier to investment. There are also control, security and insurance issues with certain assets (canoes etc).

Investment potential has been cited by PFOs to support the case for longer term agreements, but how much PFO investment has there been? There has been investment in canoe/kayak rentals at certain destination parks, but we are not aware of any investment in any shower buildings – one of the most commonly cited examples of potential investment. In our view, major PFO investments are very unlikely for most parks.

For that reason, we view the PFO relationship as essentially a revenue collection and maintenance services contract, for which a five year term is appropriate. The use of five year agreements would in most cases provide for more competition, and reduces the need for the mid-term re-negotiation.

It is worth retaining the ten year term, and/or five year extension option for those rare situations in which additional investment was proposed in the tender process.

<u>Recommendations</u>

We recommend that Parks use a five year agreement for the majority of its parks maintenance agreements.

We recommend that longer terms, or extensions to the five year term be used only where the proponent is committing to making investments that would warrant such a longer term.

6.3 Other Revenue

PFO s are now able to generate other revenue from additional services provided to park users, but which is specifically excluded from the operations under the agreement. There are also clauses restricting access to the financial information associated with such revenue. The separation of other revenue and the restriction of access to such information are odd as the revenue would not exist without the basic operations under the agreement. An additional problem is that most PFOs are not removing all the costs connected to the revenue, and notably wages, from the park maintenance costs attributable to Parks.

In our view, it would make sense to merge such other revenue back into the main agreement. This would likely be unpalatable for PFOs, as it reduces the related incentive, however notional this really is in the majority of cases. If there is no appetite for rolling the other revenue back into the agreements, then there would be a need to clarify the rules around cost attribution, and obtain understanding of the revenue amounts involved.

This topic is discussed in more detail in section 4, as it relates to the requirements of the agreement.

Recommendations

We recommend that Parks consider including other revenue in the operations under the agreement.

If other revenue remains outside the agreement, then we recommend that requirements be established for proper allocation of costs to that revenue, and for Parks' access to the financial records associated with the other revenue.

6.4 Bundle Configuration

The configuration of bundles appears to be based on a number of factors including proximity, driving distance, and critical mass – sufficiently large to provide a return, yet not too large to manage.

We have not performed a complete analysis of the factors and success of bundle configuration, but based on our limited review, we are able to offer a few observations:

- The smaller bundles we reviewed generally appeared large enough to support small owner success, while the scale also enabled reasonable supervision;
- The small bundle sizes would appear to better support new entrants, but larger sizes may better support competition in certain areas/ markets;
- An additional layer of management seemed to be necessary as PFOs move beyond two bundles.

It is worth also noting that businesses that have other operations benefit through the contribution of the parks maintenance business to certain of their existing fixed costs, and so they benefit beyond the stated profit earned in their parks business.

Recommendation

We recommend that Parks consider a range of bundle sizes, to suit the market conditions in the various regional markets.

Appendix 1 - Summary of Results of PFO Compliance Reviews

Review Criteria	Results
Annual Financial Reporting	
Use of Financial Statement Template	7 of 8 PFOs used approved templates, as required under the agreement. 2 utilized the revised (2009) template, as the updated version is required for their other parks bundles. 1 PFO did not provide a financial statement template, just submitting a set of financial statements.
Financial reporting - prescribed elements:	
➢ Income statement	All 8 PFOs submitted income statements. 2 PFOs combined results with another bundle and 1 PFO with other business operations.
➢ Balance sheet	All 8 PFOs submitted balance sheets. 3 of the balance sheets are of poor quality, either out of balance or with major elements missing
➢ Statement of changes in financial position	A statement of changes in financial position was submitted in 4 cases, and 2 of these statements were incomplete.
➢ A financial statement setting out gross revenue	The financial statements set out gross revenue in all cases.
The (Revenue) Financial Statement agrees to the monthly revenue and attendance reported	4 of 8 PFO financial statements agreed to the reported monthly revenue and attendance information. One had a minor difference, and 2 had differences of 2- 5% of revenue -- large enough to warrant scrutiny by the PFO. In one case, were unable to determine this.
The Financial Statement agrees to the accounting records, and accounting estimates are reasonable	5 of 8 PFOs' expenditure template information (or for 1 PFO, the financial statements submitted) agreed, or were close enough, to their accounting records. Another agreed, except for depreciation, which was reported in a higher amount than in the accounting records. In 3 cases, PFOs reports were not based entirely on the accounting records. All 3 used some estimates in the reported information. 2 of these reported higher costs than are actually incurred (I is significant), with the result that the costs appear close to budgeted amounts. In one case, were unable to determine this.

Monthly Revenue & Attendance Reporting	
Use of Park's Monthly Reporting Template	All 8 PFOs used the monthly revenue reporting template
Revenue reports are received for each operating month by park	All 8 PFOs reported revenue by park by month. In 1 case, it is not clear if the information is complete.
Financial Management	
The general ledger, supporting systems and related accounts are adequate	5 of 8 PFOs operated properly functioning accounting systems. 6 PFOs used accounting software, with charts of accounts with account categories for different cost types and in sufficient detail. However, one of these 5 did not fully separate distinct bundles in the accounting records. 2 of the 8 PFOs used excel as the accounting records, which is not suitable for this type of operation with large volumes of expenditure transactions.
Revenue systems ➢ Use of McBees or other process ➢ Pick-up and recording of receipts and revenues and their deposit	7 PFOs operated the basic revenue system of daily pick-up, with receipt issuance and proper recording (mostly through use of McBees or the computerized registration system), and recording of revenue and attendance information. In one case, we are not able to assess all aspects of the system. However, we have been made aware of an issue that resulted in the loss of cash and records for one park.
Revenue controls ➢ Reconciliation of receipts to deposits ➢ Timely deposit ➢ Other	4 of 7 PFOs reconciled deposit receipts to recorded revenue, 3 did this for each deposit, and one did this monthly. 3 did not perform reconciliations. One is not known. 4 of 7 PFOs deposited receipts on a timely basis, and 3 did not. 3 PFOs use additional checks such as comparison between daily receipts and spot checks of receipts issued.

Expenditures properly reflect operations – costs are adequately supported and assumptions are reasonable	5 of 8 PFO's reported expenditures are a proper reflection of actual operating costs. 2 used estimates that did not reflect actual costs. One PFO included personal expenses, and costs that should have been capitalized. 5 of 8 PFO statements involved allocation of costs between operating divisions. The allocations were reasonable. Only 2 of 8 PFOs fully separated costs relating to other revenue items that are not part of the agreement

Payroll systems are adequate and reliable	As expected, payroll was generally handled well. We were able to review this in all cases. All 8 PFOs used timesheets, and payroll was properly recorded in accounting records. 2 PFOs utilized payroll service companies.
Capital equipment and assets ➢ Equipment and assets are appropriately capitalized ➢ Depreciation is appropriately calculated and reasonable	5 of 8 maintained records (ledger or list) of capital equipment at March 31, 2010, and another recently implemented an equipment ledger. 2 PFOs did not have clear records. 3 PFOs reported correct amounts of depreciation, and 2 reported incorrect amounts. One reported a reasonable amount less than actual. For the 2 PFOs with no records, we were unable to assess the depreciation charge, but they appear minimal.
Preventative maintenance ➢ Report actual or agreed amount ➢ Costs segregated	5 of 8 PFOs report actual preventative maintenance costs, while 2 report the agreed amount. One is not known. 3 of 8 PFOs segregate these costs from regular costs. The 2 PFOs that reported the agreed amount also left the costs in regular costs, and so effectively double-counted costs in reports.
Other Requirements	
Liability insurance	All 8 PFOs had comprehensive/commercial general liability insurance of at least $2,000,000, and automobile liability insurance of $2,000,000. One is verbal confirmation only.
WCB coverage	7 PFOs were registered with Worksafe BC. Not known in one case.
HST registration	All 8 PFOs were HST registered.

Appendix 2 - Report Format Summarizing Compliance for Each PFO

	Satisfactory	Mostly satisfactory	Improvement required	Not reviewed
Annual Financial Reporting				
Use of Park's Financial Statement Template, or other approved financial report format				
Financial reporting has the prescribed elements: - Income statement - Balance sheet (statement of financial position) - Statement of changes in financial position - A financial statement setting out gross revenue, which is reconciled to the monthly revenue reports				
The (Revenue) Financial Statement agrees to the monthly revenue and attendance reported				
All revenue and cost categories in the financial statement template are addressed				
The Financial Statement agrees to the accounting records, and accounting estimates are reasonable				
Monthly Revenue and Attendance Reporting				
Use of Park's Monthly Reporting Template, or other approved report format				
All revenue categories are included in monthly reports				

	Satisfactory	Mostly satisfactory	Improvement required	Not reviewed
Revenue and attendance reported are based on McBee receipts issued, or other approved receipt system				
Revenue reports are received for each operating month by park				
Financial Management				
The general ledger, supporting systems and related accounts are adequate - General ledger exists, is maintained and up to date - Revenue and expenditure categories in the chart of accounts are in sufficient detail and properly reflect operations - Systems in place for accounts receivable and accounts payable				
Revenue systems are adequate and reliable - Process for park revenue collection - Use of McBees, as required - Pick-up and recording of receipts and revenues and their deposit - Recording of deposits to the appropriate revenue accounts				
Expenditure systems are adequate and reliable - Costs are adequately supported - Expenditures are appropriately classified				
Assumptions are reasonable				
Costs are valid and reasonable				

	Satisfactory	Mostly satisfactory	Improvement required	Not reviewed
Payroll systems are adequate and reliable - Use of timesheets - Approval of timesheets - Recording payroll in the G/L				
Capital equipment and assets - Equipment and assets are appropriately capitalized - Depreciation is appropriately calculated and reasonable				
Compliance with Agreement – Other				
Preventative maintenance - Parks notified within 30 days of completion - Invoices submitted to Parks				
Comprehensive/commercial general liability insurance of at least $2,000,000				
Automobile liability insurance of $2,000,000				
Watercraft liability insurance				
All risks property insurance				
WCB coverage				
HST registered				
Other				
PFO cooperation with process				