# Comments on Financial Statements of the Province

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## Contents

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## Introduction

3.1 The Auditor General Act requires us to examine the financial statements of the Province of New Brunswick and express an opinion as to whether they fairly present information in accordance with the stated accounting policies of the Province.

3.2 We have given an unqualified opinion on the financial statements of the Province for the year ended 31 March 1995.

3.3 The Province's audited financial statements are included in Volume 1 of the Public Accounts. This year the Public Accounts are issued in three volumes in contrast to two volumes in the past. Volume 1 now contains only the audited financial statements whereas in the past it also included supplementary financial information. The supplementary financial information is now included in Volume 2 of the Public Accounts. Our audit opinion does not cover information included in Volume 2. Volume 3 contains financial statements of Crown agencies and trust funds, each with separate audit opinions.

3.4 We have three primary goals in this section of the Report:

- To help the reader form an opinion on how the financial resources of the Province have been managed.

We do this by reporting a series of indicators of the Province's financial condition, providing year to year comparisons where possible.

- To help the reader interpret the Province's financial statements.

We explain key changes in the financial statements since the previous year. We also present additional information from an objective viewpoint which provides a clearer picture of matters reported in the financial statements.

- To focus on important issues related to the financial statements.

There may be situations where we agree with the presentation followed but we feel there are other relevant facts which the reader should consider. In other cases, we may disagree with how an event is reflected in the financial statements. We will explain our point of view.

3.5 From time to time the Province makes major changes in accounting policies. These changes make year to year comparisons of financial results difficult. Because it is not always possible to restate previous years' data, comparisons to that data could be misleading and as a result should be done very carefully. There was a major change in 1994-95 with the introduction of consolidated financial statements for the first time. We will attempt to make it clear when we have used data from previous years that was not restated for consistency with subsequent changes in accounting or disclosure.

## Results in Brief

3.6 We have given an unqualified opinion on the 1994-95 financial statements.

3.7 Consolidated financial statements have been prepared for the first time.

3.8 The deficit of $4.3 million and the accumulated deficit of $8.3 million of the Mental Health Commission have been excluded from the financial statements.

3.9 The debt incurred by the Province on behalf of NB Power Corporation ($2.8 billion) has not been disclosed on the statement of financial position.

3.10 We have been unable to meet our legislated deadline for the issuance of our annual Report for the first time.

3.11 There is no commitment by the Province to ensure the annual financial statements are issued on a timely basis.

3.12 Board of Management has not given the required approval for interprogram transfers of departmental funding.

3.13 Expressed in terms of the amounts attributable to each New Brunswicker, the net debt has risen from $7,208 to $7,270, borrowing cost has risen from $772 to $848 and the deficit has fallen from $330 to $84 per person

3.14 Net debt as a percentage of gross domestic product declined in 1994-95.

3.15 Pension expense recorded for 1994-95 was $39.1 million compared to $133.1 million (restated) just two years previously.

3.16 There has still been no actuarial valuation since 1978 for the members of the Legislative Assembly pension plan

## Highlights of the 1994-95 Financial Statements

3.17 In 1994-95, the Province's financial statements were issued for the first time on a consolidated basis. The changes to the financial statements result from the implementation of a new definition of the reporting entity.

## Consolidated Financial Statements

### A New Format

3.18 In the past, the Province and each of the Crown agencies issued separate financial statements and there was no combination of the results. The provincial reporting entity was comprised of the government departments plus any financial transactions between the departments and Crown agencies.

3.19 Note 1 to the financial statements identifies the components of the provincial reporting entity under the new consolidated financial statements format.

3.20 Consolidated financial statements are beneficial. They include much more information. The result is a set of financial statements which is designed to show the financial position of the Province of New Brunswick as a whole.

3.21 These consolidated financial statements will now be the only audited financial statements published by the Province. This is a positive move. To publish financial statements using the old format in addition to the consolidated financial statements (as is done in some jurisdictions) would be unnecessarily confusing.

### The Reporting Entity

3.22 The changes which have been made to the financial statements in order to accommodate the new reporting entity in 1994-95 are not simple ones. In general, the accounts of those organizations which are part of the reporting entity are either combined with the corresponding accounts of the departments or are shown as an investment. In the latter case, an annual gain or loss is also recorded.

3.23 The exceptions to this are the organizations which are not significant in terms of their net assets or their annual surplus or deficit. These organizations are shown in the same manner as they were in the past: only their transactions with departments are recorded.

3.24 There are six organizations whose accounts are recorded as investments. These organizations are referred to as government enterprises. Government enterprises must meet certain criteria in order to be recorded as an investment of the reporting entity.

3.25 The inclusion of government enterprises as investments had a much greater impact on financial reporting in 1994-95 than the inclusion of organizations whose accounts were combined with the Province's accounts. The government enterprises recorded as investments were:

Algonquin Properties Limited
Lotteries Commission of New Brunswick
New Brunswick Liquor Corporation
New Brunswick Municipal Finance Corporation
New Brunswick Power Corporation
Workplace Health, Safety and Compensation Commission

3.26 Note 2 to the Province's financial statements explains the impact of including the latter four Crown agencies in the reporting entity. (The impact of the first two was minimal)

- the opening balance of net debt was decreased by $376.2 million; and
- the 1994-95 deficit was reduced by $65.8 million from the amount which would otherwise have been reported.

### Omission of the Mental Health Commission of New Brunswick

3.27 Based on the criteria set by the Province for the preparation of consolidated financial statements there is one more organization which should be included in the reporting entity. The

Mental Health Commission of New Brunswick was excluded from the entity as the result of a decision by the Board of Management.

3.28 Had the Commission been fully included in the consolidated financial statements of the Province, the expenditures would have been higher by $4.3 million and the net debt would have been higher by $8.3 million. We informed the Office of the Comptroller that we consider the financial statements misstated by these amounts.

## Compliance with the Legislation to Balance Ordinary Account Revenue and Expenditure

3.29 Note 5 to the financial statements presents information explaining the progress to date on the government's commitment to balance the ordinary account revenue and expenditures over the three year period beginning 1 April 1993 and ending 31 March 1996.

3.30 The move to issue consolidated financial statements results in a different calculation of surplus and deficit. It also changes the calculation of ordinary account revenue and expenditure by including the results of operations of government enterprises.

3.31 Including government enterprises in the calculation of the ordinary account surplus for the 1994-95 year had the following impact:

| | |
|---|---|
| Unadjusted ordinary account surplus | $ 70.5 million |
| Net revenue from government enterprises | $65.6 million |
| Adjusted ordinary account surplus ( as reported) | $136.1 million |

3.32 The change was not retroactive so it did not impact on the results of the 1993-94 year.

3.33 Such changes to the calculation of the ordinary account surplus or deficit are permitted under section 5 of the legislation respecting the balancing of the ordinary expenditures and revenues.

3.34 Note 5 to the financial statements shows a cumulative deficit of $1.6 million for the first two years of the balanced budget legislation.

3.35 Had it not been for the accounting change, the Province would have shown a cumulative ordinary account deficit of $67.2 million at 31 March 1995.

## Disclosure of Provincial Debt incurred on behalf of NB Power Corporation

3.36 In our last Report we explained changes in the disclosure of NB Power Corporation debt on the Province's statement of financial position. The Province borrows on behalf of the Corporation and until last year showed this borrowing on the statement of financial position. Beginning with the 1994-95 financial statements there is a further change to this disclosure.

3.37 The Province's borrowing on behalf of NB Power ($2.8 billion at 31 March 1995) is no longer shown on the statement of financial position. When the change to consolidated financial statements took place, the operations of NB Power Corporation began to be reflected simply as an investment which is adjusted for the net income for the year. The amount of its debt is a component of the investment recorded by the Province. As a result of this change, the total amount of provincial debt issued and outstanding at year end is no longer as clear to the reader.

3.38 The financial statements explain the debt of the Corporation is not reported as part of funded debt and capital loans outstanding. In Note 8, a reference is made to the amount of "debt financing through the Province" and other long-term debt of the Corporation. Note 10 to the financial statements discloses the total debt outstanding in the name of the Province.

3.39 At year end the total debt outstanding in the name of the Province stood at $9.1 billion. In our opinion, this information is significant to the readers of the financial statements, and should be clearly disclosed on the statement of financial position.

## Delay in Completing the Province's Financial Statements

3.40 Last year we expressed our concern that the Province's financial statements are not being released within a reasonable period after the fiscal year end. This year, the audited financial statements have again been issued many months after the Province's year end. In fact, the situation has deteriorated since we expressed our concern last year.

### Background

3.41 Section 48 of the Financial Administration Act establishes a deadline for the completion of the financial statements. The section states the Minister of Finance shall lay the Public Accounts of the Province, which includes the audited financial statements, before the legislative assembly on December 31 if the Legislature is in session on that date or within ten days of the commencement of the next session if the Legislature is not in session on that date.

3.42 The legislation provides the deadline for completion of the public accounts. The latest possible date should not, however, be considered the goal of the Province. In our opinion the goal should be to provide useful financial information at the most appropriate time.

3.43 In our Report last year we quoted the following from the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants:

> Financial statement information is used to help make assessments and judgments on government financial operations and management. The usefulness of information, however, diminishes as time elapses. Financial statements should, therefore be completed as soon as possible after the end of the accounting period and issued as soon as completed.

3.44 Prior to 1993, the annual audited financial statements were issued in the Royal Gazette. This meant they were available to the public by the end of September. Since then, however, the first release of the audited financial statements has been in the Public Accounts. The earliest release of the financial statements for the past four years is as follows:

| | |
|---|---|
| 1991 September 30 | (Royal Gazette) |
| 1992 September 24 | (Royal Gazette) |
| 1993 September 30 | (Royal Gazette) |
| 1994 December 22 | (Public Accounts) |

3.45 The 1994-95 financial statements are expected to be issued in early January, 1996.

3.46 The Auditor General Act requires us to submit our annual Report to the Speaker of the Legislative Assembly on or before the thirty-first day of December. However, we cannot complete our audit work and our annual Report until we receive a final draft of the Province's financial statements. It follows, therefore, that the later the completion of the financial statements, the later the issuance of our annual Report and the less useful all this information is to the reader. This year, for the first time since our legislation was proclaimed in 1982, we are unable to meet our legislated reporting deadline.

## Reason for the Delay

3.47 Last year there were two main reasons for the delay in completing the financial statements; the October equalization adjustment from the Government of Canada and the completion of the actuarial valuations of the Public Service and Teachers' Pension Plans. This year there are even more issues being resolved late in the year.

3.48 Although we have never been officially notified, the Province has clearly adopted a policy of issuing financial statements only when the October equalization adjustments are available and have been reflected in provincial revenue. We received final notification in November 1995 for these adjustments. Among the other issues not resolved until November were:

- actuarial adjustments as a result of changes to the assumptions of pension plans;
- accounting for the newly established Crown agency called the New Brunswick Highway Corporation (see below); and
- accounting for costs associated with a study by Andersen Consulting (discussed in section 1 of this Report).

3.49 Our audit of the financial information begins long before we receive the final draft of the financial statements. There are, however, many audit procedures which cannot be conducted until the Province has dealt with all year end issues and properly accounted for them in the financial statements.

## Our Concerns

3.50 We have an additional concern arising from the late issuance of the financial statements. In September 1995, almost six months after the end of the 1994-95 year, the government released unaudited financial statements to the public via the Royal Gazette. These financial statements presented a much different picture of revenue and expenditure from that which appears in the audited financial statements. The differences arise from accounting policy decisions made by the Government well after the end of the 1994-95 year.

3.51 We found two of these accounting policy adjustments to be of special significance. The unaudited financial statements released in the Royal Gazette in September 1995 included revenue of $30 million from the sale of property by the Province to the New Brunswick Highway Corporation. This newly formed Corporation was expected to purchase the property using a loan from the Province, and repay the loan through revenues it generated from its operations. The $30 million in revenue was later removed from the Province's records and is not included in the final draft of the financial statements because the details of the Corporation's operations had not been finalized in time.

3.52 Further, the unaudited financial statement included $45.2 million in pension expenditures which were later removed from the draft. Changes were made to the assumptions used to calculate the pension liability. The adjustment reflected the impact these changes had on the pension expense recorded for the year.

3.53 In addition to the two matters above, late adjustments were also made to revenue from Canada. The October adjustment increased revenues by $18.5 million. The final settlement of the fiscal stabilization claim in late November decreased revenues by $15.2 million.

3.54 Each time a revised version of the financial statements is prepared and each time the media reports a different result, the process becomes more confusing to the public.

3.55 We repeat our comment from last year that a realistic goal would be to release the audited financial statements within three months of the year end.

3.56 We are concerned there is no commitment by the Province to complete its financial statements in a timely manner. Late financial information becomes less useful and less relevant to legislators and the public.

3.57 We are also concerned about the impact of referring to different versions of the draft information during the period of delay. This can lead to confusion and misinterpretation on the part of the users of the financial information.

3.58 The Comptroller has again indicated support for the earlier release of the Province's audited financial statements.

## 1994-95 Approved Spending

3.59 The appropriation for the 1994-95 year has several components. These components combine to show the total allowed level of spending for departments and agencies for the year. The components include:

- the main estimates;
- supplementary estimates; and
- special warrants including the year-end warrant.

3.60 An appropriation is defined as an amount that is approved by vote of the Legislature. Ordinary account spending is voted on a departmental basis, with the exception of proposed expenditures of General Government and the Legislative Assembly which are voted by program. Appropriations for capital spending and loans and advances are also voted on a program-by-program basis.

3.61 For the past three years departments have had the flexibility to move their approved funding among ordinary account programs without seeking a supplementary appropriation. In some cases transfers between programs must receive prior approval of the Board of Management. Cumulative transfers of $1,000,000 or 15% of the budget of the program, whichever is the lesser, require such approval. This means that individual ordinary account programs may now be overspent so long as the total departmental spending on ordinary account falls within the budget.

3.62 We checked for prior Board of Management (BOM) approvals where transfers between programs exceeded the allowable cumulative amounts noted above. We found no prior BOM approval for any of these transfers which involved seven departments and totalled approximately $4.4 million.

3.63 The following table shows the components of the year's expenditure appropriations on a comparative basis.

| | (Millions of dollars) | | | |
|---|---|---|---|---|
| | **1992** | **1993** | **1994** | **1995** |
| Main estimates | 4,295.6 | 4,487.4 | 4,297.1 | 4,284.1 |
| Supplementary estimates | 40.5 | 31.1 | 63.5 | 43.9 |
| Special warrants | 66.6 | 23.5 | 0.3 | 0.2 |
| | 4,402.7 | 4,542.0 | 4,360.9 | 4,328.2 |

3.64 There was only a one-day fall session of the Legislative Assembly in 1995. Year end amounts totalling $32.2 million have not yet been approved either by way of a special warrant or supplementary estimates. We are therefore required to report that appropriations have been exceeded by this amount.

## Net Budgeting

3.65 A change to the Financial Administration Act now gives Board of Management the authority to allow net budgeting. The change was made in response to demand for more flexibility in managing programs where services are provided on a cost-recovery basis. Departments may be permitted to budget for the net amount of expenditure or revenue for those revenue-generating programs that have received Board of Management approval. Net budgets are approved as part of the annual budget process and are monitored on a quarterly basis. The change took effect in December 1994 and as of the 31 March 1995 year end there were four approved net budgeted government programs. These were administered by the Departments of Advanced Education and Labour, Human Resources Development and Natural Resources and Energy.

3.66 As a result of our annual audit of expenditures we found the Department of Natural Resources and Energy had netted expenditures against revenues without making an application to or receiving approval from Board of Management.

## Carry Over of Unspent Appropriations

3.67 The Financial Administration Act was also amended in December, 1994 to give authority to the Board of Management to approve the carry-over of unspent appropriations from one fiscal year to the next without further authorization by the Legislature. As a result of this amendment, departments will be eligible to apply for approval to spend their unused 1995 fiscal year budget in the 1996 fiscal year.

## Special Operating Agency

3.68 A special operating agency (SOA) was included in the Province's financial statements for the first time in 1993-94. The SOA was created under the authority of the Regional Development Corporation Act (RDC Act) for the purpose of providing financial management for the Canada-NB Infrastructure Program Agreement. The infrastructure program is funded by the federal, provincial and municipal governments and by private sector sources.

3.69 The Province’s share of funding to the SOA is provided through budgetary appropriations by several departments. The enacting legislation, in this case the RDC Act, permits the SOA to carry forward the unused portion of these appropriations to subsequent years. The establishment of the Infrastructure SOA in 1993-94 enabled the Province to carry forward $3.5 million of unused capital budget from 1993-94 to spend on the infrastructure program in future years.

3.70 The Province has made these recent changes to the manner in which government spending is approved, as outlined above, for the stated purpose of providing managers flexibility to more effectively manage programs.

## Deficits, Borrowing and Net Debt

3.71 The purpose of this section is to provide readers with useful information and analysis on which to draw their own conclusions about the status of the Province's deficits, borrowing and net debt. It is not the purpose of this section to provide a conclusion about the financial stability or solvency of the Province.

### Definitions

3.72 The following definitions correspond to balances reported in the Province's annual financial statements. The balances reported by the Province constitute important financial data. Our last annual Report attempted to place some of this data in perspective. This year we are providing comparative information. Our office will continue to provide such comparisons so that the reader may better understand the Province's financial history, current status and future goals.

3.73 To understand the current financial situation of the Province, it is necessary to be familiar with the terminology often used: deficit, cost of servicing the public debt, funded debt and capital loans, bank advances and short term borrowing, sinking fund and net debt.

3.74 The deficit in a fiscal year is the excess of the Province's total expenditure over its total revenue. Expenditures include the cost of administering the government and its programs, the acquisition of assets which will provide benefits over future periods and the cost of borrowing.

3.75 The cost of servicing the public debt is a major component of the annual deficit. It is mainly comprised of interest on the funded debt of the Province. It also includes foreign exchange paid on interest and maturities during the year, the amortization of foreign exchange gains and losses which have not yet been realized, and the amortization of discounts and premiums which were incurred on the issuance of provincial debt.

3.76 Funded debt is the long-term borrowing of the Province. Borrowing usually occurs when the Province's cash inflows are not sufficient to meet its obligations. Sustained deficits can be a major factor behind a province's requirement for long-term borrowing. Funded debt usually takes the form of provincial bonds, but it may also include either debt issued to the Canada Pension Plan or capital loans. The debt issued to the Canada Pension Plan accounts for

16 percent of the Province's debt. This level is consistent with prior years. The Province's capital loans were obtained in prior years under a program sponsored by the federal government. Capital loans now account for only 0.2% of the total borrowing by the Province.

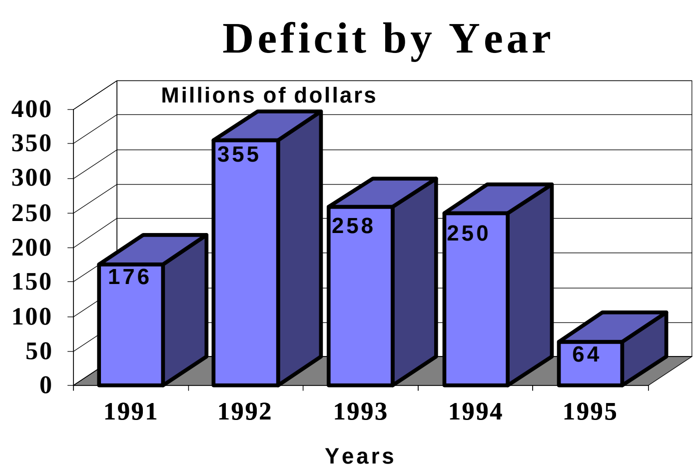
3.77 The Province must often incur another form of debt to meet its current obligations. Bank advances and short term borrowing are a form of financing used when the Province's immediate cash requirements do not coincide with its current cash inflows.

3.78 The Province plans for the future repayment of its funded debt through the use of a sinking fund. This fund is a separate accounting entity which is maintained by the Minister of Finance. The sinking fund receives annual cash installments from the Province with which it purchases investments. The value of the investments, plus future earnings, is expected to be sufficient to repay the principal portion of the funded debt when it matures or is redeemed.

3.79 Annual deficits accumulate in the account called net debt. It is important to understand the difference between net debt and funded debt. Funded debt refers to the amounts borrowed while net debt is comparable to an accumulated deficit which private sector companies would disclose in the owners' equity section of the balance sheet.

Deficit for the year ended 31 March 1995

3.80 The Province's deficit for the year ended 31 March 1995 was $64 million. This amount includes the surpluses and deficits of government enterprises as described in Note 1 of the Province's financial statements. The prior year's figures have been restated to conform with the current year's presentation. The following chart shows the amount of the deficit (restated) for each of the last five years:



3.81 The 1994-95 deficit translates to a $84 share for each person living in New Brunswick[1]. This is down from last year's (restated) figure of $330 per person.[2] The decrease is chiefly due to a reduction in the deficit rather than a change in the population. The deficit was reduced because growth in the Province's revenues exceeded growth in expenditures.

3.82 Examining the deficit from the perspective of the employed New Brunswicker might provide a better measure of its size. The Province would have needed to collect an additional $208 in taxes from each employed person in New Brunswick to eliminate the 1994-95 deficit[3]. It is interesting to note that the Province already collected on average approximately $2,810 in provincial income taxes from each employed New Brunswicker in 1994-95[3]. In 1993-94, the Province would have needed to collect an additional $820 per employed person (restated) to eliminate the deficit for the year[4].

3.83 The following example provides a simple illustration of the impact of a deficit. If the Province were to finance the current year's deficit of $64.0 million using the year-end provincial borrowing rate, monthly principal and interest payments of approximately $575,000 would be required over a period of twenty years. The total paid would be $138 million.

3.84 There is not always a direct relationship between the level of annual deficits and the need to borrow. Deficits are an accounting term used to describe the differences between a current year's revenues and expenditures. Revenues are recorded in the financial statements when earned, expenses when the obligation arises. However, the related cash receipts or payments may not occur in the same fiscal period.

3.85 These actual cash flows, as disclosed on the Province's Statement of Changes in Financial Position, dictated the extent to which the Province needed to borrow funds during the year to meet its cash requirements.

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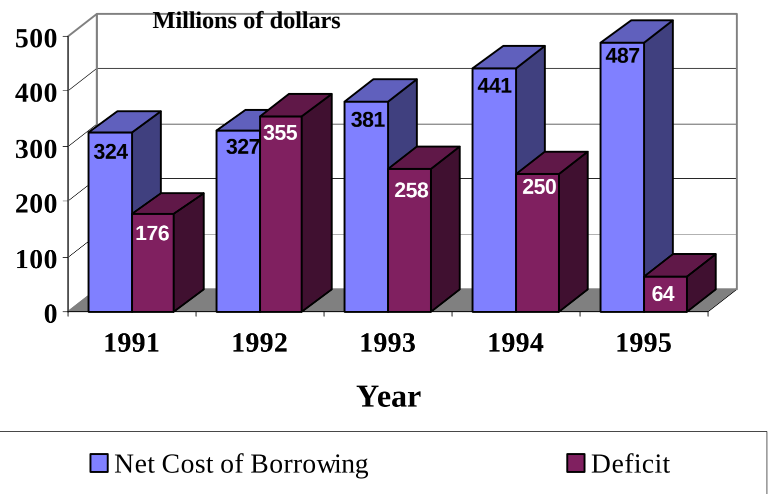
[1] Population as at 31 March 1995 per N.B. Statistics Agency.
[2] Population as at 31 March 1994 per N.B. Statistics Agency.
[3] Employment figures based on annual average for 1994 per N.B. Statistics Agency.
[4] Employment figures based on annual average for 1993 per N.B. Statistics Agency.

3.86 The cost of servicing the public debt in 1994-95 exceeds the deficit for the year. If the Province had not been required to borrow funds in previous years, then there would be neither a significant cost of servicing the public debt nor interest revenue from the Province's sinking fund. If these items were excluded (other factors remaining the same), the current year would have shown a surplus in excess of $423 million.

3.87 The following chart demonstrates the relationship between the Province's net cost of borrowing and annual deficits.

**A Comparison of Deficits and the Net Cost of Borrowing**



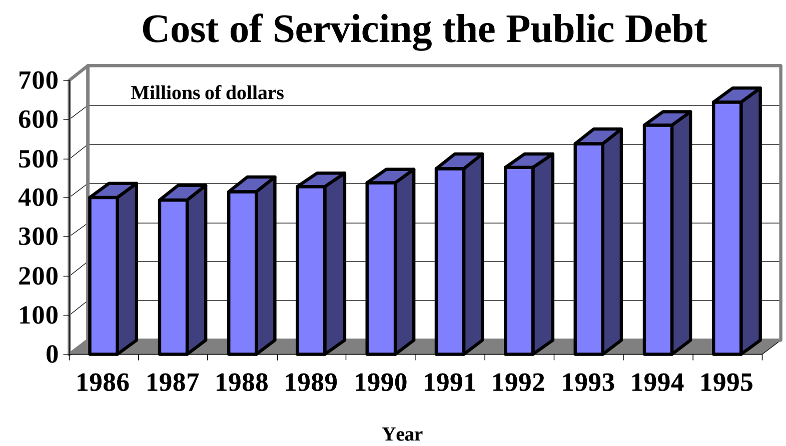

Note: The net cost of borrowing shown above offsets sinking fund earnings against the cost of servicing the public debt.

3.88 It is evident that without the financial effects of the Province's debt, much smaller deficits, or even surpluses, may have resulted during the last five years.

## Cost of Servicing the Public Debt

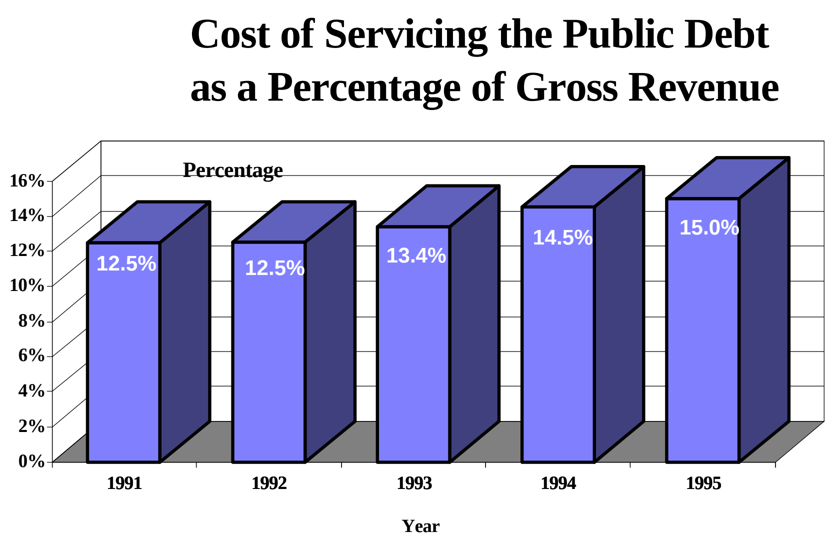
3.89 Since the Province does not always have sufficient funds from revenue to cover all expenditure, including the interest incurred on public debt, funds may be borrowed to ensure the Province's obligations are met. Essentially, interest on prior borrowings becomes part of the current debt and compounding occurs. For each year that this occurs, the cost of servicing the public debt will tend to rise.

3.90 The following chart shows the cost of servicing the public debt by year for the last ten years:




3.91 During this period the cost of servicing the public debt has risen from $400.1 million to $644.6 million. This represents an increase of 61.1%. It is important to note that the cost of servicing the public debt which is disclosed in the financial statements does not include the cost of borrowing of government enterprises. The cost of borrowing of these organizations has been recorded in their expenditures and reduces their net income to the amount shown in Note 8 to the Province's financial statements.

3.92 The following chart shows the portion of provincial revenue consumed by the cost of the public debt for the last five years:



3.93 The increase from 14.5% in 1993-94 to 15.0% in 1994-95 is the net result of an increase in borrowing costs of $59.5 million combined with an increase in revenue of approximately $271.0 million. The higher borrowing costs resulted from increases in interest and foreign exchange. The higher revenue was mostly due to an increase in equalization payments during 1994-95. Consumption tax and income tax revenues also increased during this fiscal year. If 1994-95 revenues had remained at the prior year's level, the percentage consumed by the cost of borrowing would have increased to 16%.

3.94 Although the percentage of revenue consumed by the cost of borrowing increased by only a small amount over the prior year, the cost of borrowing is still at the highest level in the past ten years.

3.95 This year's cost of borrowing amounts to $848 for each person living in New Brunswick[5]. Expressed another way, in the Province's cost of borrowing for 1994-95 averages out to $2,100 for each employed New Brunswicker[6].

## Funded Debt

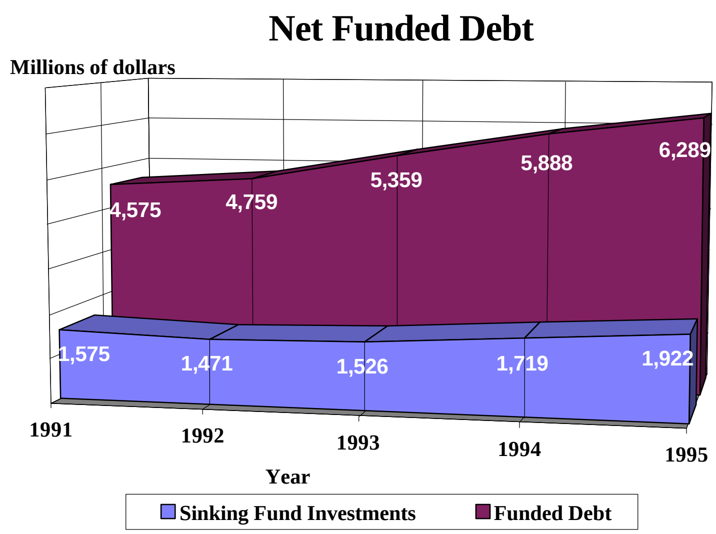
3.96 In the past year, provincial bonds were sold for periods ranging from five to ten years. The following table summarizes the activity in the funded debt account during the last five years:

| | (Millions of dollars) | | | | |
|---|---|---|---|---|---|
| | 1991 | 1992 | 1993 | 1994 | 1995 |
| Opening balance | 4,311.1 | 4,574.7 | 4,758.7 | 5,358.5 | 5,887.6 |
| Borrowing during the year | 440.6 | 643.7 | 949.1 | 634.3 | 708.0 |
| Debt redeemed | (174.5) | (473.6) | (427.6) | (278.2) | (412.1) |
| Adjustment for the change in exchange rates | (2.5) | 13.9 | 78.3 | 173.0 | 105.3 |
| Closing balance | 4,574.7 | 4,758.7 | 5,358.5 | 5,887.6 | 6,288.8 |

3.97 The increase in total provincial debt of the Province during the year is partially offset by the increase in investments of the sinking fund. During the year ended 31 March 1995 the compensating increase in the sinking fund investments was $202.8 million.

5 Population as at 31 March 1995 per N.B. Statistics Agency.
6 Employment figures based on annual average for 1994 per N.B. Statistics Agency.

3.98 The following chart shows the relationship between the total provincial debt and sinking fund investments for the last five years:



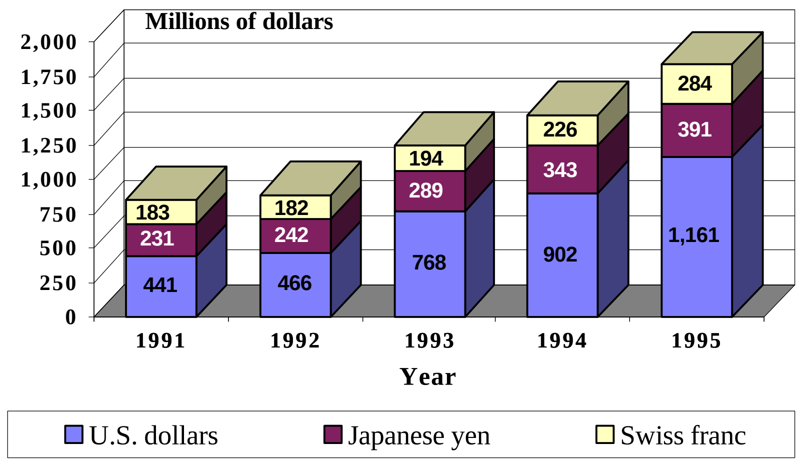

3.99 Provincial debt repayable in foreign currencies is denominated in US dollars, Japanese yen and Swiss francs. Between 31 March 1994 and 31 March 1995 the Canadian dollar depreciated against all of these currencies. The net result was an unfavourable adjustment of $105.3 million. This loss will be recorded in the expenditures of the Province over the remaining life of the related debt. The adjustment for the change in exchange rates has increased the amount of the provincial debt in each of the last four years.

3.100 The following table summarizes the exposure of the Province to foreign exchange rate fluctuations over the past five years:

| | (Millions of dollars) | | | | |
|---|---|---|---|---|---|
| | **1991** | **1992** | **1993** | **1994** | **1995** |
| Debt payable in foreign currencies | 1,419.4 | 1,135.0 | 1,307.5 | 1,555.6 | 1,953.7 |
| Less: Foreign issues with fixed exchange rates | 53.4 | 23.3 | - | - | - |
| Less: Investment in foreign currencies | 511.6 | 222.1 | 56.0 | 85.5 | 117.7 |
| | 854.4 | 889.6 | 1,251.5 | 1,470.1 | 1,836.0 |
| Percentage of total debt | 18.7% | 18.7% | 23.4% | 25.0% | 29.2% |

3.101 The following chart demonstrates the increase in the Province's exposure to foreign currencies, and the components of that exposure, for each of the last five years:

## Net Exposure to Foreign Currencies




3.102 The Province has several alternatives to reduce the risk associated with debt repayable in foreign currencies. Each of the following will act as a hedge to fluctuations in foreign currencies:

- purchasing assets denominated in foreign currencies for the Province's sinking fund;
- entering into debt swap agreements (which in most cases allows repayment of the debt in Canadian dollars); and
- entering into forward contracts (which allow the Province to purchase a foreign currency at a stipulated price on a specified future date).

3.103 Note 10 to the financial statements of the Province discloses the debt that is repayable under swap agreements. This debt is excluded from the above chart and previous table except where the debt was payable in US dollars under a swap agreement.

3.104 The Province did not enter into any forward contracts to fix exchange rates for foreign issues in 1994-95.

3.105 The previous table shows that exposure to gains and losses due to foreign currency exchange rate fluctuations at 31 March 1995 has increased by $365.9 million over 31 March 1994. Officials from the Department of Finance provided the following explanation for this increase:

> Due to the heavy reliance on the Canadian market during the 1993-94 fiscal year and the weakness of the Canadian dollar during fiscal 1994-95, the proportion of US dollar borrowings was increased. There were no additional yen or Swiss franc liabilities incurred as a result of borrowings in fiscal 1994-95.

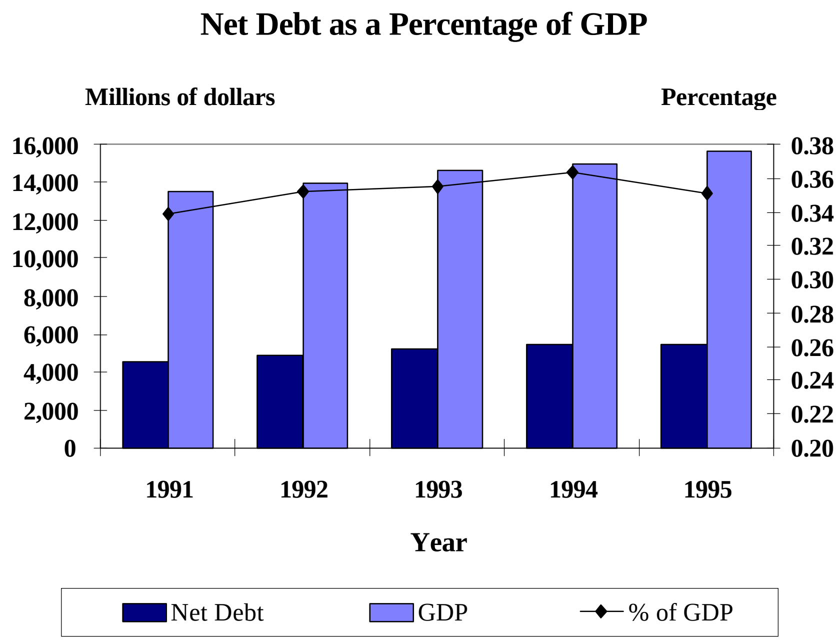
## Net Debt at 31 March 1995

3.106 As noted previously, net debt increased by $64.0 million during the 1994-95 year. The amount of net debt at 31 March 1995 stands at $7,270 per person living in New Brunswick or approximately $18,000 for each employed person in New Brunswick. The average wage of a New Brunswicker was $26,160 at 31 December 1994.[7]

3.107 Net debt as a percentage of gross domestic product (GDP) is frequently used to measure a government's ability to sustain its debt. GDP is a measure of the current market value of all goods and services produced in the Province during a year. The market value used in our calculation includes taxes (less subsidies) which make up part of the market price. A decreasing ratio of net debt to GDP would indicate that the Province's economy is growing at a greater rate than the debt. This implies that the Provincial economy has more resources available with which it can maintain its debt. The Province's current net debt to GDP ratio is approximately 35%.

3.108 The following chart shows the relationship between the Province's net debt and its GDP for the last five years:

[7] Population figure as at 31 March 1995 per N.B. Statistics Agency. Employment and average wage figures based on annual average for 1994 per N.B. Statistics Agency.




Note: 1995 GDP estimate and historical GDP information obtained from N.B. Statistics Agency

3.109 The net debt to GDP ratio showed a modest decrease in 1994-95. This indicates that growth in the provincial economy occurred at a rate greater than the growth of the Province's net debt.

## Eliminating the Net Debt

3.110 All levels of government in Canada are trying to come to terms with the problems raised by years of deficits. The Province of New Brunswick is no exception.

3.111 The government would need surpluses of $276.3 million per year for a period of twenty years to eliminate its existing net debt.

3.112 During 1992-93, the Province announced its intention to implement balanced budget legislation. The "Act Respecting the Balancing of the Ordinary Expenditures and Ordinary Revenues of the Province" was given Royal assent on 7 May 1993. The Province is now required to ensure that its ordinary account expenditure does not exceed ordinary revenue for the period commencing 1 April 1993 and ending 31 March 1996.

3.113 Ordinary account revenue consists mainly of provincial taxes, fees, licenses, permits and federal government transfers. Ordinary account expenditure consists of the costs of operating the provincial government. It excludes the cost of acquiring, constructing or renovating the Province's physical assets such as its roads, hospitals and schools. In addition, the Province is including the net income or loss from government enterprises as ordinary revenues for the first time in 1994-95.

3.114 The Minister of Finance stated in his 1994-95 budget,

> With a revised estimate of $131.5 million for the ordinary account deficit for 1993-94, a budgeted ordinary account surplus of $4.8 million in 1994-95 and a forecast surplus of $138.3 million for 1995-96, the 1994-95 Budget will ensure that the province will have balanced its ordinary account over the three-year period.

3.115 The Province’s final results show an ordinary account surplus in 1994-95 of $90.8 million. The actual ordinary surplus exceeds the budget by $41.5 million. This was achieved because actual revenue exceeded budget by $48.5 million and $7 million in unanticipated expenditures were incurred.

3.116 Balancing the ordinary account is only part of the solution. On 13 April 1995, Royal Assent was granted to an amendment to the balanced budget legislation. This amendment requires the Province to ensure that total expenditures do not exceed total revenues during each four year period subsequent to 31 March 1996.

3.117 In assessing New Brunswick's progress in these and other areas, it is useful to obtain independent evaluation. Standard & Poor's, a leading bond rating agency, notes that the Province has an "excellent track record” in expenditure restraints. This is one of the factors which resulted in the maintenance of the Province’s AA-rating as well as a revision in the investor’s outlook from “negative” to “stable” during June 1995.

## Summary

3.118 The following information summarizes the impact of the Province’s current financial results from the perspective of a resident of the Province of New Brunswick.

| | For each New Brunswicker in | |
|---|---|---|
| | 1994-95 | 1993-94 |
| Borrowing cost | $ 848 | $ 772 |
| Deficit | 84 | 330 |
| Net debt | 7,270 | 7,208 |

| | For each employed New Brunswicker in | |
|---|---|---|
| | 1994-95 | 1993-94 |
| Borrowing cost | 2,100 | 1,918 |
| Deficit | 208 | 820 |
| Net debt | 17,997 | 17,905 |
| Other: | | |
| Provincial income taxes | 2,810 | 2,686 |
| Average wage | 26,160 | 26,228 |

3.119 We will try to provide understandable information on the Province's deficits, borrowing and net debt on a consistent basis in our Annual Reports. This will help the reader to understand the issues surrounding the management of the Province's finances.

## Accounting for Loans Receivable

3.120 The Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants issues recommendations designed to improve and harmonize accounting, auditing and financial reporting in the public sector. PSAAB recently issued recommendations which cover accounting for loans receivable.

3.121 PSAAB defines a loan receivable (a definition which includes advances) as a financial asset of a government represented by a promise by a borrower to repay a specific amount, at a specific time or times, or on demand, usually with interest.

3.122 The concept put forth by PSAAB is that there is a cost incurred by governments when a loan is not required to be fully repaid including interest charged at market rates. This cost must be recognized and accounted for in the proper accounting period and the loans must be correctly valued.

3.123 PSAAB focused its recommendations on concessionary loans. These are loans with low interest rates, extended repayment terms or forgiveness clauses.

3.124 The Province does not, at present, account for concessionary loans in accordance with these recommendations. There are cases of loans issued with low interest, loans issued with no interest and loans with no repayment terms. All are recorded at the full amount of the loan, with no adjustment to reflect the concessions given to the borrower.

3.125 An example of a concessionary loan is a $4 million advance made in the 1984-85 year to La Fondation du quotidien francophone, in connection with the French language daily newspaper. This amount is shown in schedule 6 to the financial statements as part of the Province's outstanding loans and advances. There are no specified repayment terms and the interest earned is not the property of the Province.

3.126 Another example is the $5 million advance to the Fundy Trail Trust fund. This is also recorded as an asset in the loans and advances of the Province shown in schedule 6. There have been no repayments since the trust was established in 1990, no interest has accrued to the benefit of the province and repayment is unlikely before termination of the agreement in the year 2010.

3.127 In both cases, based on PSAAB recommendations, the disbursement of funds would have been recorded as an expenditure.

3.128 The Department of Economic Development and Tourism carries a significant balance of concessionary loans.

3.129 The issue of accounting for concessionary loans was discussed with the Comptroller . She indicated her office has been reviewing the matter prior to bringing forward recommendations to the Board of Management.

3.130 We plan to review this issue again in the 1995-96 year.

## Environmental Liabilities

3.131 Information on the Province's environmental responsibility is disclosed in the notes to the financial statements. It is the Province's policy not to recognize environmental liabilities in the financial statements .

## Landfills and Dumps

3.132 The Province has agreed to cost share with municipalities the remediation of closed landfills/dumps. It has estimated its one-half share of the costs of cleanup at $18.0 million ($18.7 million in 1994). While this liability has accumulated over a number of years, formal cost estimates were only available last year.

3.133 A 1993 Canadian Institute of Chartered Accountants' research report titled "Environmental Costs and Liabilities: Accounting and Financial Reporting Issues" discussed this issue and made several recommendations on how reporting of environmental costs and liabilities might be improved. One of the major issues addressed was the question of when a future environmental expenditure should be recognized as a liability. The report concluded that "if future expenditures relate to environmental damage that has already occurred, the liability for cleanup should be recognized, provided it can be estimated".

3.134 It is our opinion the future costs of site remediation meet this criteria. The Province has disclosed the amount of the liability in the notes to financial statements.

## Mining Operations

3.135 The Province has also recognized a responsibility for environmental damages caused by mining operations. An agreement has been reached with one mining company limiting the company's liability for environmental damages which occurred prior to the date it began mining the site. The agreement holds the company liable for the first $3 million of site remediation costs. According to the terms of the agreement the company has provided an insurance bond of $1.3 million as security for its liability. The Province has not disclosed any liability it may have under this agreement as no reasonable estimate of the costs is available.

3.136 The Province has identified other mining locations where site remediation is necessary. We were informed that the mining companies involved have accepted responsibility for the cleanup and have provided the Province with adequate security to cover the costs.

## Actuarial Valuations and Pension Plan Liabilities

### Purpose of the Actuarial Valuations

3.137 The Province's pension obligation results from a promise to provide pensions to employees in return for services. The employees' entitlement to pensions is earned over the term of their employment. When the assets of a pension plan do not equal the pension obligation, the difference is called the pension liability or pension surplus and it is calculated through an actuarial valuation.

3.138 The Canadian Institute of Chartered Accountants defines an actuarial valuation for accounting purposes as follows:

> … an assessment of the financial status of a pension plan. It consists of the valuation of assets held by the fund and the calculation of the actuarial present value of benefits to be paid under the plan.

3.139 The valuation provides the information needed to determine the pension liability and related pension expenditures.

3.140 Actuaries utilize several sources of information in arriving at the estimated surplus or liability at the valuation date. Included are historical government payroll records, government assumptions affecting the future revenue and expenditure of the funds and information available to the actuaries, for example life expectancy estimates of contributors.

### Changes in Assumptions and the Impact on the Liability

3.141 Each time a valuation is conducted, a new estimate of the plan's liability or surplus is prepared. There are a number of key assumptions which can result in major changes to the liability or surplus. Note 11 to the financial statements lists four of the assumptions: rate of return on fund assets, annual wage and salary increases, inflation and rate of pension payment escalation. There are other assumptions that are considered such as mortality rates, retirement ages, percent of members married and rates of employment terminations.

3.142 Several changes were made to the assumptions used this year. The long term assumptions for rate of return on assets, inflation, and annual wage and salary increases were adjusted for several pension plans. This makes them more uniform with the other plans. In addition, the actuarial assumptions for most of the pension plans have been adjusted to reflect short term estimates.

3.143 Recent wage and salary settlements and anticipated settlements in the near future are inconsistent with the long range estimates upon which the plans had been valued. The introduction of short term assumptions allows for recognition of the current economic environment. Over time, these short term assumptions gradually converge to the long term assumptions shown in Note 11 to the financial statements.

3.144 The introduction of short term assumptions had a significant impact on the liabilities of the Public Service and Teachers' Pension Plans. Had the latest valuations for accounting purposes been prepared using assumptions identical to the previous valuation, the difference in the estimated liabilities of the two plans would be sizeable. The liability of the Public Service Plan would be greater by $101.2 million and the Teachers' Plan would have a liability $168.7 million greater.

## Pension Liabilities and Pension Cost

3.145 The following table shows the components of the pension liability recorded in the financial statements for the past four years. The figures used are those previously published for the respective years. They have not been restated for subsequent changes due to new valuations or changes in accounting policies.

millions of dollars

| | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|
| Estimated Accrued Benefits | 3,900.4 | 4,137.3 | 4,339.0 | 4,374.3 |
| Value of Assets | 2,250.0 | 2,844.8 | 3,403.1 | 3,701.5 |
| Actuarial Pension Liability | 1,650.4 | 1,292.5 | 935.9 | 672.8 |
| Unamortized Adjustments | -- | 353.2 | 650.2 | 794.9 |
| Pension Liability for Accounting Purposes | 1,650.4 | 1,645.7 | 1,586.1 | 1,467.4 |

3.146 There has been a steady decline in the pension liability for accounting purposes from $1,650.4 million in 1992 to $1,467.4 million in 1995. The decline is a product of both growing fund assets and adjustments to the estimated accrued benefits. Excess contributions made by the Province to the Public Service and Teachers' Pension Plans have accelerated the increase in the value of assets. The majority of the adjustments to the estimated accrued benefits are being amortized over periods ranging from 15 to 22 years.

3.147 What is significant about the pension liability for accounting purposes is that it is decreasing to a large degree without making significant changes to the funding from the Province or the employees. Much of the change comes from amortization of actuarial adjustments.

3.148 The most dramatic change is the reduction in the actuarial pension liability from $1,650.4 million in 1992 to $672.8 million in 1995.

3.149 Ultimately the changes to the actuarial pension liability are reflected in the pension expense. The following table shows the pension expense for the past three years. The amounts for 1993 and 1994 have been restated on a basis consistent with that used in 1995.

millions of dollars

| | Employers' Share of Benefits Earned | Pension Interest Cost | Amortization of Adjustments | Crown Agency Payments | Pension Expense |
|---|---|---|---|---|---|
| 1993 | 85.3 | 100.0 | (24.6) | (27.6) | 133.1 |
| 1994 | 66.8 | 73.8 | (47.0) | (7.1) | 86.5 |
| 1995 | 57.8 | 45.6 | (57.0) | (7.3) | 39.1 |

3.150 This table shows the four components of the pension expense recorded in the Province's financial statements. It is composed of a cost based on the actuarial assumptions, interest on unfunded amounts, an adjustment due to experience gains or losses and changes to actuarial assumptions, and a reduction for special payments made by certain Crown agencies.

3.151 Significant amortization adjustments were recorded in the past two years. Dramatic decreases in pension expense resulted. The adjustments made to assumptions adopted in previous actuarial valuations have reduced pension expense recorded today and into the future.

## Future Actuarial Valuations

3.152 The Canadian Institute of Chartered Accountants recommends that "actuarial valuations of pension obligations for accounting purposes should be done at least once every three years." According to the Department of Finance no formal plan is in place to regulate frequency of the valuations.

## Liability for the Members' Pension Plan

3.153 Last year we again expressed our concern that there had been no actuarial valuation of the pension liability for the members of the Legislative Assembly since 1978. All pension plans except this one have had an actuarial valuation within the past three years.

3.154 Last year we commented:

> We repeat our recommendation that an actuarial valuation should be prepared for the Members' plan. Without this valuation, there is inadequate assurance the liabilities have been reasonably estimated. Accountability is not served by using out of date and potentially misleading financial information.
>
> A significant increase in the expense of future years could result, should the next actuarial valuation confirm a large understatement of the pension liability of the Members' plan.

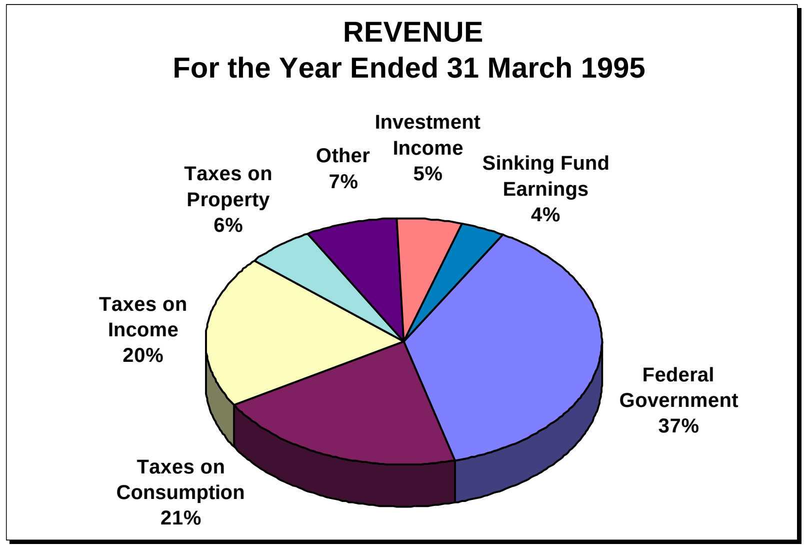
3.155 The valuation was not completed during the 1994-95 year so our concern remains unaddressed at year end. However, as disclosed in note 11 to the Province's financial statements, a valuation is expected to be completed for the year ending 31 March 1996.

## Revenue and Expenditure

### Sources of Revenue

3.156 The Province's revenue comes mainly from taxes on consumption, income and property and from federal transfer payments. Other sources of revenue include investment income from government enterprises, licenses and permits, sales of goods and services, forestry and mines royalties, interest and other sundry sources.

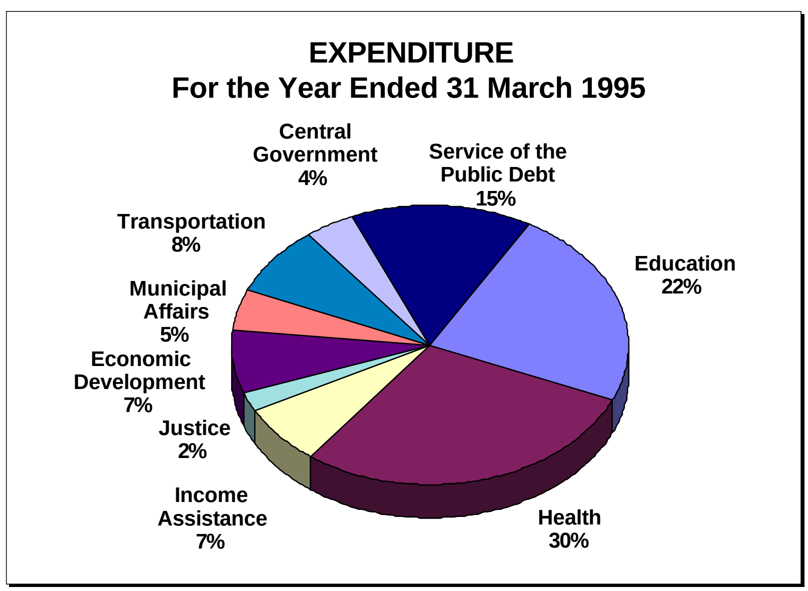
3.157 The following chart shows the main components and their percentage of total revenue.




## Types of Expenditure

3.158 The Province spends the bulk of its money on social services; namely health, education and income assistance. In addition, as noted elsewhere in this section, an increasing share of expenditures is going to service the public debt. Other expenditures consist of funds spent on transportation, economic development, municipal affairs, central government and justice.

3.159 The following chart shows the main components and their percentage of total expenditures.



## Actual Results Compared to the Prior Year

| | (Millions of dollars) | | |
|---|---|---|---|
| | Revenue | Expenditure | Deficit |
| 1995 actual | 4,293.9 | 4,357.9 | 64.0 |
| 1994 actual | 4,022.9 | 4,272.9 | 250.0 |
| Change from prior year | 271.0 | 85.0 | (186.0) |

3.160 Actual revenue for 1994 has been restated to include investment income from government enterprises. This reduces the deficit reported last year of $290.7 million to $250.0 million.

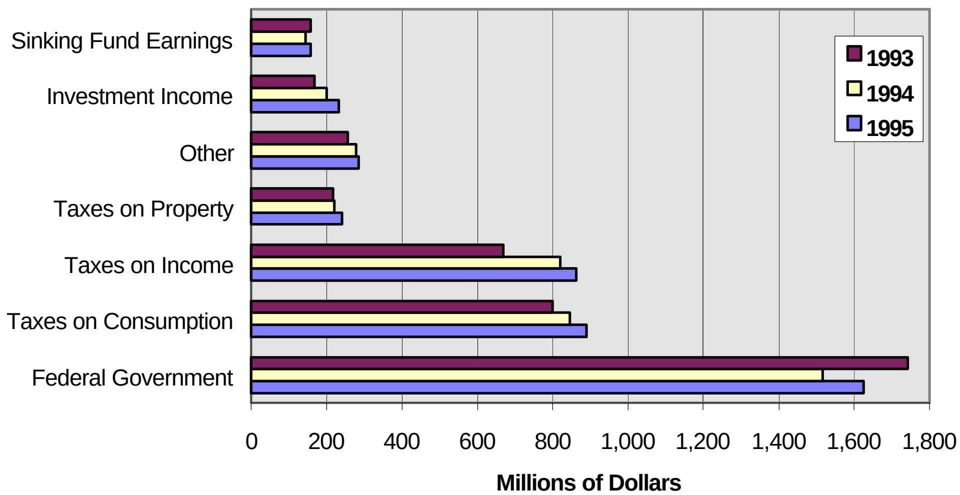
3.161 In our year-end audit of the Province's financial statements we obtained explanations for significant differences between the 1993-94 and the 1994-95 results. We identified and analyzed all large or unusual year-to-year fluctuations in both revenue and expenditure accounts.

3.162 The increase in revenue is largely the result of fiscal equalization/stabilization payments which increased by $106.1 million. Increases in taxes on income of $43.4 million, taxes on consumption of $44.1 million and investment income of $32.5 million contributed to the overall increase in revenue.

3.163 On the expenditure side, the largest increase was in the cost of servicing the public debt which rose by $59.5 million over the prior year. The other increases of significance were in health and economic development where spending increased by $40.0 million and $22.6 million respectively. These were offset in part by a decrease of $30.3 million in education expenditures.

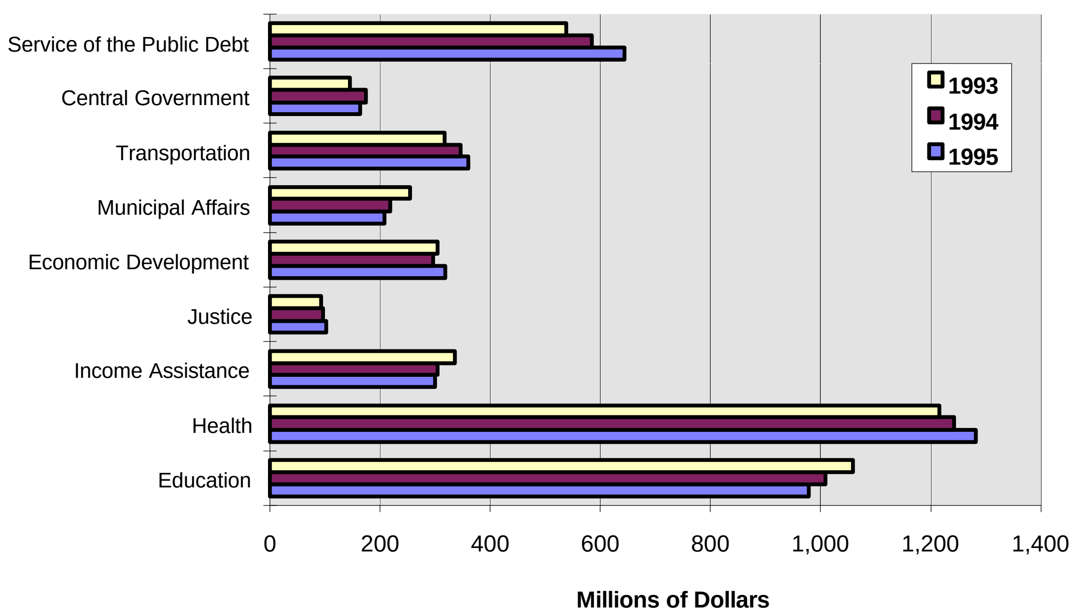
3.164 The charts below illustrate the variations in revenues and expenditure by source over the most recent three-year period.

## Revenue by Source




Investment income for 1993 and 1994 has been restated to include income from government enterprises.

## Expenditure by Source



Budgeted Results Compared to Actual Results

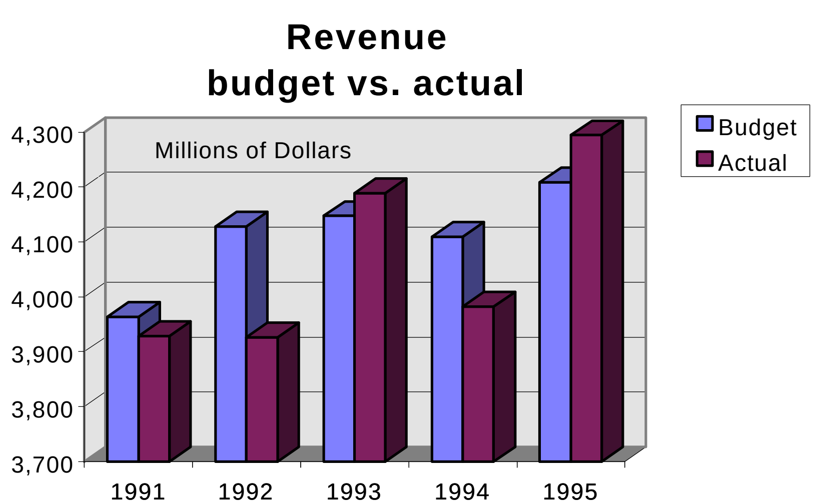
| | (Millions of dollars) Revenue | Expenditure | Deficit |
|---|---|---|---|
| 1995 budget | 4,207.8 | 4,284.1 | 76.3 |
| 1995 actual | 4,293.9 | 4,357.9 | 64.0 |
| Over (under) budget | 86.1 | 73.8 | (12.3) |

3.165 Total federal revenue exceeded expected levels by $30.9 million. Investment income was $25.3 million higher than budgeted, because income from the Workplace Health, Safety and Compensation Commission was $29.1 million in excess of its budget.

3.166 The most significant difference in actual expenditures compared to budget was for service of the public debt which was overspent by $72.6 million. In addition, spending on transportation exceeded budget by $40.8 million, while education expenditures were $34.0 million under budget for the year.

3.167 Overall, both revenues and expenditures were overbudget by $86.1 million (2.0%) and $73.8 million (1.7%) respectively. This resulted in a deficit that was $12.3 million (16.1%) less than anticipated.

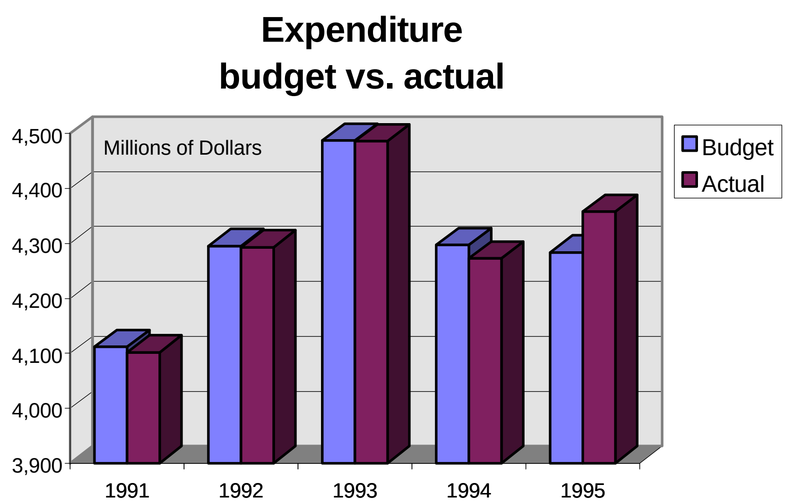
3.168 The following chart compares the annual budgeted revenue to actual revenue for the last five years:



3.169 Budgeted and actual revenue for government enterprises is only included for 1995. We have not restated prior year amounts for this change in accounting policy.

3.170 1995 is one of only two years in the past five where actual revenues exceeded the budget. It is also the only year wherein the actual results were significantly better than budgeted.

3.171 The following chart compares the annual budgeted expenditure to actual expenditure for the last five years:




3.172 1995 marks the first of five years wherein actual expenditures exceeded the budget. It is also the only year showing a significant difference between budget and actual results.

## Special Purpose Accounts

3.173 Certain accounts of the Province have been designated as special purpose accounts. A special purpose account is established when activities are funded by revenues that have been designated for specific purposes by donor request, legislation or funding agreements. Note 7 to the Province's financial statements provides a breakdown of the special purpose revenue, expenditure and equity by account.

3.174 The annual budget estimates prepared for these accounts are included with the main estimates of the Province each year. They are also disclosed in the notes to the financial statements. However, the estimates for special purpose accounts are different from the ordinary and capital accounts because spending beyond the estimated levels does not require the approval of the Legislative Assembly.

3.175 Section 33(1) of the Financial Administration Act specifies "money paid to the Province for a special purpose and deposited to the credit of the Consolidated Fund may be paid out of the Consolidated Fund for that purpose". As long as expenditures do not exceed the assets of the fund, there is no requirement to obtain legislative approval of such expenditures.

3.176 The cumulative balance of the special purpose funds at year end is $15.5 million. Total expenditure for the year exceeded revenue by $1.2 million. Of the $38.5 million in revenue reported for special purpose accounts, $10.8 million (28%) is from lottery revenue, $4.4 million (11%) is from environmental fees, $6.7 million (17%) is from contract training fees and $6.4 million (17%) is from federal grants.

3.177 There were no new special purpose accounts established this year involving significant revenues and expenditures.