Chapter 2
Comments on Financial Statements of the Province

Contents

Comments on Financial Statements of the Province

Background

2.1 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.

2.2 The Province's audited financial statements are included in Volume 1 of the Public Accounts. Volume 2 provides supplementary unaudited financial information. The financial statements of Crown agencies and trust funds are contained in Volume 3.

2.3 We have three primary goals in this chapter 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.

2.4 From time to time the Province makes major changes in accounting policies. For example there was a major change in 1994-95 with the introduction of consolidated financial statements for the first time. 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. 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.

Scope

2.5 In fulfilling our responsibility to carry out the audit of the financial statements of the Province of New Brunswick, we conduct audits in accordance with generally accepted auditing standards. Based on the results of our audits, we issue an opinion on the financial statements of the Province. This chapter of the Report presents an overview of the main issues arising from the 1996 audit of the financial statements. Matters that have arisen during the financial statement audits that relate specifically to departmental operations, government programs, Crown agencies and trusts are discussed elsewhere in this Report.

Results in brief

2.6 **The Province issued its audited financial statements earlier than last year.**

2.7 **The Province made a commitment to issue future financial statements by 31 August.**

2.8 **We have issued an unqualified audit opinion on the financial statements of the Province for the year ended 31 March 1996.**

2.9 **Disclosure of the debt incurred by the Province for NB Power Corporation has been improved.**

2.10 **The government met its commitment to balance its ordinary account revenue and expenditures over a three year period.**

2.11 **Major new leases are being signed by the Province which could have a significant impact on the annual surplus or deficit.**

2.12 **Pension liabilities and pension expenses continue to fall.**

2.13 **The Members' Superannuation Plan shows a liability of $27.7 million after its first valuation in eighteen years.**

2.14 **A slight rise in the level of borrowing is offset by increases in sinking fund investments.**

2.15 **Expressed in terms of the amounts attributable to each New Brunswicker, the net debt has declined to $7,244 from $7,335, borrowing cost has declined to $781 from $849 and there is a surplus of $67 compared to a 1995 deficit of $90 per person.**

2.16 **Net debt as a percentage of gross domestic product declined in 1995-96.**

Highlights of the 1995-96 financial statements

Disclosure of NB Power Corporation debt has been improved

2.17 Borrowing for the NB Power Corporation (the corporation) has been reflected differently in the Province's financial statements in each of the past four years. In 1992-93 the amount was shown as both an investment and a liability. In the 1993-94 financial statements, the corporation's borrowing was shown as a deduction from the total borrowings of the Province. Last year, the first year of consolidated reporting, the borrowing for the corporation was not shown on the statement of financial position at all.

2.18 The 1995-96 financial statements show the total funded debt of the Province ($9,421.2 million). The borrowing for the corporation ($3,113.4 million) is then shown as a deduction from the total to arrive at the funded debt for provincial purposes ($6,307.8 million). This is a clear disclosure of not only the total borrowing activity carried on by the Province, but also the borrowing for the corporation.

2.19 This change to the disclosure of the debt satisfies the concerns we expressed in last year's Report.

Adjustments to opening balance of net debt

2.20 Under certain circumstances it is acceptable to restate the balances reported in the financial statements of a previous year. Either a change in accounting policy or the correction of an error in a previous year could result in a retroactive restatement of the results of previous years. As described in Note 2 to the financial statements, the opening balance of the 1995-96 net debt was increased by $46.1 million over the amount previously reported at 31 March 1995. Changes in accounting policies resulting in the reclassification of two Crown agencies and the recording of the recently estimated actuarial liability under the Members' Superannuation Plan accounted for the increase.

Comments on the legislation for balancing revenue and expenditure

2.21 The 1995-96 year was the end of a three-year period in which the government committed to balance its ordinary revenue and expenditure accounts. Note 5 to the financial statements presents the final results of the three year initiative. The final figures show a cumulative surplus of $228.2 million.

2.22 Consolidated financial statements were prepared for the first time in 1994-95. At that time the Province's financial statements began to include, as ordinary account revenue, the net revenue from all government enterprises. Prior to this time only revenue from certain enterprises (e.g. New Brunswick Liquor Corporation and Lotteries Commission of New Brunswick) was included in the Province's revenue. The major result of this change was to bring in revenue from New Brunswick Power Corporation and the Workplace Health, Safety and Compensation Commission of New Brunswick.

2.23 Last year we commented that the change in accounting for government enterprises had a significant impact on the calculation of the ordinary account surplus for the purposes of the balanced budget legislation. The reported results of the ordinary account were a surplus of $136.1 million. Without the benefit of the revenue generated by the government enterprises, the surplus would have been $70.5 million for 1994-95.

2.24 The following exhibit reports the impact of the revenue from government enterprises on the ordinary account results for both the 1994-95 year and the 1995-96 year.

Exhibit 2.1

Cumulative ordinary account surplus 1994 to 1996 (millions of dollars)

Adjusted surplus (deficit) used in the calculation	
1993-94	
1994-95	(137.7)
1995-96	136.1
	229.8
Cumulative surplus reported in Note 5	228.2
Less: Revenue from New Brunswick Power Corporation and Workplace Health, Safety and Compensation Commission	
1994-95	(65.6)
1995-96	(50.1)
Cumulative surplus without government enterprises	**112.5**

2.25 Over the two-year period, ordinary account surplus was increased by $115.7 million as a result of the accounting change ($50.1 million from 1995-96 and $65.6 from 1994-95). Since the reported cumulative surplus exceeded this amount, we conclude that the change in accounting for government enterprises did not determine whether the requirements of the legislation were met.

2.26 A new balanced budget period begins in 1996-97. The amendments to the balanced budget legislation describe the next fiscal period as beginning 1 April 1996 and ending four years later on 31 March 2000. The wording of the new legislation focuses on all revenue and expenditure rather than just ordinary account revenue and expenditure. The annual and the cumulative results are required to be disclosed in the Public Accounts.

Major new leases are being signed by the Province

2.27 During the 1995-96 year, the Province signed an agreement which will see a private company construct and own a public school facility. Subsequent to the year end, the Province signed a lease agreement with another company which will construct and own a correctional facility. In both cases the properties will be leased back to the Province for a twenty-five year period and are renewable at the Province's option for a further ten year period. There is an option for the Province to purchase the properties at the end of the twenty-five year period.

2.28 The size of the two projects is significant. The total interest and principal payments over the twenty-five years is $67.7 million. A further $8.3 million will be paid should both projects be extended to the full term of thirty-five years. Lease payments begin on the school lease in the 1996-97 year while the correctional facility payments start in 1997-98.

2.29 Funding the costs of these capital facilities is very different from that seen in the past. Traditionally such assets were constructed, financed and owned by the Province and the amounts recorded in the financial statements were the costs incurred in the year.

2.30 There are accounting implications to these new arrangements. If these leases are to be recorded as capital leases, accounting rules require the value of the property to be expensed at the commencement of the lease term. If on the other hand the lease was considered to be an operating lease, the cost of using the facilities for the term would be recognized over the twenty-five or thirty-five year period.

2.31 The latter treatment would result in a far lower expenditure in the initial year. It would also result in either a lower deficit or higher surplus than would have been reported if the transaction were recorded as a capital lease. The costs would be recorded over the term of the lease.

2.32 Since the Province charges its capital costs to expense in the year they are incurred, obtaining capital assets through operating leases would be a significant change in the way costs are recorded in the Province's financial statements.

2.33 We will examine the accounting treatment and financial statement presentation for the leases during the current year.

Explaining the impact of surpluses or deficits on borrowing activities

2.34 There is an important distinction between the surplus or deficit experienced in a year and the change in the level of borrowing which takes place during the same period. To highlight this distinction a new note was added to the Province's financial statements. Note 16 is titled, "change in provincial borrowing". This note reconciles the surplus of the past year to the decrease in borrowing, showing the major components of the differences between the two figures.

2.35 Last year we discussed this issue in the accountability section of our Report under the heading "despite a balanced budget, borrowing may still be required." We pointed out the importance of recognizing that even though the net debt may decrease in any given year, the total interest bearing debt may still have to increase to finance the cash requirements of government.

2.36 Our interest in clarifying this relationship between surplus or deficit and borrowing has been satisfied through the introduction of this note.

Modifications to the statement of changes in financial position

2.37 The statement of changes in financial position has been renamed the statement of cash flow. The reason for the new name is to give the statement a title which better describes the purpose of the statement and the information it provides.

2.38 The general purpose and content of the statement remain the same with the exception of the introduction of information on the purchase and disposal of capital assets. In the past the capital items were included with the operating activities and were not shown separately as investing transactions. The results from 1994-95 have been restated and are on the same reporting basis as the current year.

Timing of the release of the financial statements

2.39 In last year's Report we raised three issues with respect to the release of the Province's financial statements.

- We repeated our comment that a realistic goal would be to release the audited financial statements within three months of the year end.
- We expressed our concern that there was 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.
- We pointed out the negative impact of referring to different versions of the draft information during the delay. This is something that could lead to confusion and misinterpretation on the part of the users of the financial information.

2.40 There have been changes during the past year which impact on each of these three comments.

Earlier release of the financial statements

2.41 The Province's audited financial statements for the year ended 31 March 1996 were released on 8 October 1996. This compares to a date of 21 December 1995 for the 1994-95 financial statements. This is an improvement over last year and is an improvement on the 1993-94 year as well.

2.42 The release dates of the audited financial statements and the means by which they became available to the public over the past five years are as follows.

Exhibit 2.2

Release dates of audited financial statements

1992	24 September	(Royal Gazette)
1993	30 September	(Royal Gazette)
1994	22 December	(Public Accounts)
1995	21 December	(Tabled with the Clerk of the Legislative Assembly)
1996	8 October	(Tabled with the Clerk of the Legislative Assembly)

2.43 We held several discussions with the Comptroller and the Deputy Minister of Finance concerning the issue date for the financial statements. Early indications to our Office were that the Minister of Finance was committed to make all information available to us by 31 October 1996 to allow completion of the audit. However in July we were informed of the possibility of not only an earlier preparation of the financial statements but also a potential earlier release date.

2.44 The audit of the Province of New Brunswick financial statements is a major component of the annual work schedule for the staff of our Office. This schedule involves many audits in addition to the financial statement audit of the Province and is not easily altered in such a major way without significant effort on the part of our staff. In some cases such a change comes at the expense of other audit work which we are expected to complete on a timely basis.

2.45 There was little time to prepare for the alterations to the original deadlines. Nevertheless, the financial statements were completed and issued much earlier than last year, as a result of good cooperation between staff of our Office and the Comptroller's Office.

Commitment to early release in future years

2.46 We have talked with the Department of Finance and the Comptroller concerning the release date of the financial statements in the future. We were informed that there was serious interest in releasing the financial statements even earlier in future years.

2.47 Subsequent to these meetings the Board of Management approved a commitment to issue audited financial statements by the end of August each year. Complying with this would result in an improvement of more than one month over 1996.

2.48 Our Office plans to work with the Office of the Comptroller to explore ways to improve the efficiency of the year end process through which the financial statements are prepared and audited. With cooperation between the two offices we expect that both the final draft of the financial statements and the audited copy can be completed in time to meet the August deadline.

Comments on the composition of the provincial reporting entity

2.49 The term provincial reporting entity is used to describe the total number of organizations that are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the legislature and are owned or controlled by the government. Note 1 to the financial statements lists the organizations included in the reporting entity.

Changes in the reporting entity

2.50 Algonquin Properties Limited is no longer classified as a government enterprise. This change takes place in 1995-96 and results from a redefinition of the term government enterprise by the Public Sector Accounting and Auditing Board. It is now accounted for on the consolidated basis. The opening balance of net debt has been adjusted to reflect the retroactive application of this change.

2.51 The New Brunswick Investment Management Corporation has been added to the list of organizations included through consolidation. This organization was formed during the year and as disclosed in Note 4 (e) it operated as a special operating agency up to 11 March 1996, at which time it was incorporated.

2.52 The Kingsbrae Horticultural Garden and The New Brunswick Biotechnology and Technological Innovation Centre of Excellence Inc. were both added to the list of organizations included through consolidation. These organizations are recorded as special purpose funds and their financial information is summarized in Note 7 to the financial statements under the Department of Agriculture.

Mental Health Commission

2.53 Last year we reported that the accounts of the Mental Health Commission had been recorded incorrectly in the financial statements. We explained that based on the criteria set by the Province for the preparation of consolidated financial statements, the Mental Health Commission should have been consolidated. The 1994-95 expenditures reported for the Province would have been higher by $4.3 million and the net debt would have been $8.3 million higher had the Commission’s accounts been recorded correctly.

2.54 In the 1995-96 financial statements the Mental Health Commission has been consolidated. Its losses from previous years were added to the opening balance of net debt. Because of the misstatement in recording the activities of the Commission last year, the $4.3 million loss incurred in 1994-95 will never be recorded as an expenditure of the Province.

New Brunswick Highway Corporation

2.55 There has been no change in the status of the New Brunswick Highway Corporation since our last Report. The corporation is listed in Note 1 to the financial statements as an organization consolidated in the provincial reporting entity. Its existence however has no impact on the financial position and results of operations reported in the consolidated financial statements of the Province.

2.56 Property was transferred to, and is owned by, the corporation. Financial statements have not been prepared for the corporation at 31 March 1996.

New Brunswick School Boards

2.57 Note 1 to the financial statements explains that New Brunswick School Boards are reflected in the financial statements using the transaction method. School Board operations are represented in the statement of revenue and expenditure by the grants paid to them by the Department of Education. The reporting format has not changed from the previous year.

2.58 The nature of the relationship between the schools and the Department of Education has recently changed significantly. Reporting on the financial operations of the schools will change as well. Beginning with the Province's 1996-97 financial statements, the accounts of the schools will be combined with the accounts of the provincial reporting entity using the consolidation method. The impact will be to replace the grant expense, previously recorded by the Province, with the actual school expenditures. All school expenditures and revenues will now be included in the Province's financial statements under this new format.

2.59 Although the effective date of the changes to the school boards was 1 March 1996, the administrative and financial structure of the dissolved school boards was retained and continued until 30 June 1996 as specified in the legislation. For this reason the timing of the change in reporting the school board accounts does not take effect until the 1996-97 year.

Hospital corporations

2.60 No change has taken place to the definition or classification of the hospital corporations within the Provincial reporting entity. They continue to be listed in Note 1 and, as described in the note, are recorded only to the extent that there are transactions between the Province and the corporations.

2.61 Because of the way in which the hospital corporations are reflected in the financial statements, any deficits or surpluses (and the related borrowings or surplus funds) are not shown in the Province's financial statements.

2.62 There are a number of differences in the way in which the hospital corporation financial statements are prepared from that of the Province. For example, unlike the Province's financial statements where capital costs are charged to expense as incurred, the hospital corporations record such purchases as assets and amortize the cost to expenditure each year. Another difference is in the area of vacation entitlements. The hospital corporations have recorded vacation entitlements in an amount of $20.5 million at 31 March 1996. The Province does not include vacation entitlements as liabilities in its financial statements.

2.63 A review of the corporations' financial statements shows total current liabilities exceed current assets by $22.8 million. In addition there is total long term borrowing of $7.1 million and capital lease commitments of $2.8 million. These net liabilities, amounting to $32.7 million, are not recorded or reflected in the Province's financial statements or notes. There are long term investments of $23.7 million contained in three of the corporations' financial statements. We understand they have restrictions on their use.

1995-96 approved spending

2.64 An appropriation is defined as an amount that is approved by vote of the Legislature. The appropriation for the 1995-96 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.

Ordinary account spending

2.65 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 loans and advances are also voted on a program-by-program basis.

2.66 For the past four years departments have had the flexibility to move their approved funding among ordinary account programs without seeking a supplementary appropriation. 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. However, in some cases transfers between programs must receive prior approval of the Board of Management (BOM). According to administrative policy, cumulative transfers of $1,000,000 or 15% of the budget of the program, whichever is the lesser, require such prior approval.

2.67 Last year we reported that BOM approval had not been provided prior to transfers between programs which exceeded the allowable cumulative limits set by this administrative policy. The transfers involved seven departments and totalled approximately $4.4 million. Following the issuance of last year’s Report, the Department of Finance explained that the policy, as written, was not being followed at the time because plans were in place to change the approval requirements.

2.68 We have since been advised by the Budget and Financial Management Division of the Department of Finance that the policy regarding transfers between programs has been revised to incorporate the approval of such transfers into the departmental quarterly reporting process. Formal BOM approval will not be required under the new policy. The only exception will be fourth quarter transfers where the decision on the need for BOM approval is left to the BOM Chairman.

Capital account spending

2.69 In the past, appropriations for capital account spending were voted on a program-by-program basis. Beginning in the 1995-96 fiscal year, capital account spending is voted on a departmental basis. This allows departments similar flexibility for moving funds between programs as is available for ordinary account spending.

2.70 Fund transfers between programs must receive BOM approval. This approval is achieved for the first three quarters of the year through the quarterly reporting process. Transfers of funds in the fourth quarter having a value of 5% or more of the approved third quarter projection may not be made without formal BOM approval.

2.71 All transfers of capital funds in the fourth quarter were found to fall within the limits not requiring formal BOM approval.

Total spending

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

Exhibit 2.3

Expenditure appropriations (millions of dollars)

	1996	1995	1994	1993
Main estimates	4,365.6	4,284.1	4,297.1	4,487.4
Supplementary estimates	45.6	43.9	63.5	31.1
Special warrants	81.3	0.2	0.3	23.5
Total expenditures appropriated	4,492.5	4,328.2	4,360.9	4,542.0

2.73 Last year we reported that year end amounts totalling $32.2 million had not been approved either by way of a special warrant or supplementary estimates. These 1994-95 expenditures have since been approved through supplementary estimates dated 25 April 1996.

Net budgeting

2.74 The Financial Administration Act gives the Board of Management the authority to allow net budgeting. Net budgeting allows more flexibility in managing programs where services are provided on a cost-recovery basis. Departments are 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. At the 31 March 1996 year end there were seven approved net budgeted government programs. These were administered by the Executive Council Office and the Departments of Advanced Education and Labour, Economic Development and Tourism, Natural Resources and Energy and Solicitor General.

Carry over of unspent appropriations

2.75 The Financial Administration Act gives 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. Departments are eligible to apply for approval to spend their unused fiscal year budget in the following fiscal year.

2.76 During the year the Department of Transportation received approval to carry forward $4.2 million of the 1995-96 approved capital budget.

Special operating agencies

2.77 A Special Operating Agency (SOA) was first included in the provincial reporting entity in 1993-94. The number of SOAs increased to four during 1995-96, although this was reduced to three when the investment management SOA became the Investment Management Corporation just prior to year end. Note 4 (e) to the Province's financial statements identifies each agency's main purpose as well as the revenue and expenditure amounts for the year.

2.78 The SOA represents a new structure within which public policy objectives are achieved. The structure removes and/or alters some of the traditional legislative and administrative policy restrictions surrounding government program administration.

2.79 During the year we conducted a review of the Vehicle Management Agency. Details of the review are provided in chapter 8 of this Report.

Concessionary loans

2.80 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.

2.81 Last year we reported that PSAAB had issued recommendations focusing on loans which are considered to be "concessionary". Concessionary loans are ones which have low interest rates, extended repayment terms or forgiveness clauses.

2.82 There is a cost incurred by governments when a loan is not required to be fully repaid including interest charged at market rates. The cost must be recognized and accounted for in the proper accounting period and the loans must be correctly valued.

2.83 We reported last year that the Province does not account for concessionary loans in compliance with PSAAB recommendations. The Comptroller was reviewing the matter at the time before bringing forward recommendations to the Board of Management.

2.84 We recently met with the Comptroller and discussed this issue once again. He informed us there were issues related to the concessionary loans which were still unresolved including the calculation of the total amount of the concessionary loans outstanding. He said finalizing the Province's policy at this time would be premature. He assured us that the issue would be addressed in the upcoming year.

2.85 Note 1 (b) has been expanded in the 1995-96 financial statements to include more detail on the present policy for concessionary loans.

Unresolved issues affecting accounting policies

2.86 There are a number of issues with respect to the accounting policies for liabilities which the Province has yet to resolve. The notes to financial statements explain that no accrual has been made for retirement allowances and employee vacations. The notes also refer to the liability for future benefit payments to workers who are currently injured and explain that only a portion of the liability has been recorded in the financial statements. The responsibility for payments to injured workers is administered by the Workplace Health, Safety and Compensation Commission of New Brunswick.

2.87 One liability which is not referred to in the notes to financial statements will take on greater significance in the 1996-97 year. The accrual for school teachers' pay earned but unpaid at 31 March should be recorded as a liability at the 1996-97 year end.

Retirement allowances and vacation entitlements

2.88 Retirement allowances represent the most significant of the issues still outstanding, based on preliminary calculations. Although the allowances are not directly payable at 31 March, there is a benefit earned by employees and a liability incurred by the employer each year for the future allowances to be paid upon retirement. The logic for recording these allowances is therefore very similar to that for the liability for employees' pensions. Pension liabilities are recorded in the Province's financial statements on an annual basis.

2.89 Government employees earn vacation entitlements for each month of employment. At 31 March each year there are vacation entitlements which have been earned but which have not been used by the employees. Such entitlements have a value but as explained in Note 1 no accrual of the expenditure has been recorded. This treatment is unlike that used by the hospital corporations. As noted earlier in this chapter, the corporations recorded entitlements of $20.5 million at 31 March 1996.

Liability to injured workers

2.90 The matter of the liability for payment to injured workers was raised with the Comptroller this year. No action has been taken to record the difference between the estimated future payments to injured employees and the amount expensed to date.

Accrual of teachers' salaries

2.91 Teachers have an agreement where they are paid every month of the year despite the fact the school year covers only ten months. This is made possible by dividing the salary earned in the ten months into amounts which can be paid to the teachers over a twelve month period.

2.92 At 31 March, the Province's year end, the salaries earned by the teachers will exceed the amount of salary paid by a significant amount. As explained in Note 1 to the financial statements, the consolidation method of accounting will be used for New Brunswick schools beginning in the

1996-97 financial statements. This amount should be recorded as a liability in the financial statements next year.

Comments from the Comptroller

2.93 We have discussed the foregoing matters with the Comptroller. He indicated to us that his staff have started to gather the data needed to calculate the liability for vacation pay and retirement allowances for employees in Part I of the civil service. He indicated that since this was a new calculation, the data would have to be analysed carefully to ensure completeness and accuracy. Information on Parts II and III will be gathered in the near future. This will include the liability for the summer pay of teachers.

2.94 Once all data has been gathered and verified, a recommendation for the appropriate treatment will be presented to the Board of Management.

2.95 With respect to the liability for injured workers, the Comptroller responded as follows:

> *In 1995-96, the Province reported its liability as a self-insured employer in the notes to the financial statements. Previously, no disclosure had been made of this liability. We are confident that this represents an accurate estimate of the liability. The increase in the recognized portion of the liability for the year was $0.5 million.*

2.96 We will continue to meet with the Comptroller to discuss these issues and to ensure the Province's financial statements include reasonable estimates of all liabilities. It should be noted that the impact of the foregoing liabilities on the expenditures of an individual year should not be large. However there would be a significant impact on the net debt when first recognizing the amounts relating to all preceding years.

Pension plan liabilities

Background

Actuarial valuations

2.97 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.

2.98 The Canadian Institute of Chartered Accountants defines an actuarial valuation 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. The valuation results in a calculation of the required future contributions and the determination of any gains or losses since the last valuation.*

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

2.100 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.

2.101 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.

Understanding the liability

2.102 Readers of the financial statements are faced with some rather complex concepts in the area of accounting for pensions. One which is worthy of discussion is the difference between the actuarial pension liability and the pension liability for accounting purposes.

2.103 In the financial statements the focus is primarily on the liability for accounting purposes. However in terms of deciding on the funding plans for the liability, one would focus on the actuarial liability since it represents the shortfall in the value of pension fund assets below accrued pension benefits at a point in time.

2.104 Both liability figures are based on results of actuarial valuations and they are very much interrelated. It is important, however, to use them in the proper context. As auditors we refer most often to the liability for accounting purposes. What makes this value different from the actuarial liability is that there is a delay before the liability for accounting purposes recognizes any increase or decrease in the estimated amount of the liability.

2.105 For example, if a new actuarial valuation is completed and it indicates that the liability is only one half of what was originally estimated, the liability for actuarial purposes falls immediately to the revised level. For accounting purposes, however, such a treatment is not correct. By their nature, pension liabilities, as estimates, are prone to upward and downward adjustments. Because of this tendency, adjustments are not recognized all at once. Rather, they are recorded over a reasonable period of time. If this was not the case then it would be possible to have a huge increase or decrease in expenditure in the year of the new estimate of the liability. This could confuse and mislead users of the financial statements.

2.106 The end result of applying the accepted accounting practice for pension liabilities is to smooth the recognition of the adjustments. This considers the fact that the amounts are estimates, not certainties.

Changes in the year

2.107 The pension liability for accounting purposes has fallen from $1,467.7 million at the beginning of the 1995-96 year to $1,386.4 million at year end.

2.108 The 1996 financial statements disclose the pension liability for accounting purposes in a slightly different manner from previous years. Instead of showing one liability figure in the statement of financial position, it has been broken down into two components. One component represents the adjustments to be recognized in the future and the other component is the excess of the accrued pension benefits over the value of the assets held in the funds at year end (also known as the actuarial pension liability).

2.109 Actuarial valuations of pension liabilities were completed for two plans during the past year. The members' plan received its first valuation since 1978 and its estimated accrued benefits (and its pension liability) increased from the $4.3 million reported last year to $27.7 million. Valuation of the early retirement plan saw its estimated accrued benefits rise from the $15 million disclosed at 31 March 1995 to $38.8 million at 31 March 1996.

Declining pension liabilities

2.110 Increases and decreases to the pension liability for accounting purposes are the result of the combined impact of the pension expense and the employers' contributions each year. In 1995-96 the pension expense was $40.9 million. Employer contributions were $145.2 million resulting in a reduction of $104.3 million in the pension liability for accounting purposes. The situation in the previous year was similar. Pension expense was $39.1 million and employer contributions were $150 million causing a $110.9 million decline in the liability.

2.111 The following exhibit shows the declining pension liability for accounting purposes recorded in the financial statements for each of the past five years. It also shows the components of the liability at each year end. 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.

Exhibit 2.4

Components of pension liability
(millions of dollars)

	1996	1995	1994	1993	1992
Estimated accrued benefits	4,679.7	4,374.3	4,339.0	4,137.3	3,900.4
Less: Value of assets	(4,257.0)	(3,701.5)	(3,403.1)	(2,844.8)	(2,250.0)
Actuarial pension liability	422.7	672.8	935.9	1,292.5	1,650.4
Plus: Unamortized adjustments	963.7	794.9	650.2	353.2	-
Pension liability for accounting purposes	1,386.4	1,467.7	1,586.1	1,645.7	1,650.4

2.112 There has been a steady decline in the pension liability for accounting purposes from $1,650.4 million in 1992 to $1,386.4 million in 1996. The decline is a product of both growing fund assets and adjustments to the estimated accrued benefits.

2.113 A continuation of the excess contributions by the Province to the Public Service and Teachers' Pension Plans have accelerated the increase in the value of assets.

2.114 The adjustments made to actuarial assumptions adopted in previous actuarial valuations have reduced pension expense recorded today and into the future. Adjustments to the estimated accrued benefits are being amortized over periods ranging up to twenty-one years. Despite the fact the adjustments are amortized each year, the level of the unamortized balance (the amount to be amortized in future years) has increased each of the past four years. It has risen from a zero balance in 1992 to $963.7 million at the end of the 1995-96 year. The following exhibit shows how the balance has grown.

Exhibit 2.5

Unamortized pension adjustments
(millions of dollars)

	1996	1995	1994	1993	Total
Opening balance	794.9	650.2	353.2	-	-
Adjustments for the year					
Plan amendments	(30.5)	(13.9)	-	-	(44.4)
Experience gains	274.1	-	258.3	377.8	910.2
Actuarial assumptions	-	215.6	85.7	-	301.3
Less: Amortization for the year	(74.8)	(57.0)	(47.0)	(24.6)	(203.4)
Changes in the year	168.8	144.7	297.0	353.2	963.7
Closing balance	963.7	794.9	650.2	353.2	-

2.115 Annual amortization has gone from $24.6 million in 1993 to $74.8 million in 1996. The cause of this increase can be seen clearly in the adjustments for each year. Each of the last four years has seen adjustments increase by an amount in excess of $200 million.

2.116 The majority of the adjustments result from experience gains. Experience gains or losses result when the planned performance and the actual results achieved differ. As demonstrated by the experience gains shown above, the recent results have been much more favourable than anticipated in the actuarial assumptions. The other major component in the adjustments is the impact of changes in actuarial assumptions from those used in previous periods.

Pension expense is declining

2.117 Changes to the actuarial pension liability are ultimately reflected in the pension expense through the amortization of the adjustments. The following exhibit shows the pension expense for the past four years. The amounts for 1993 and 1994 have been restated on a basis consistent with that used in 1995 and 1996.

Exhibit 2.6

Pension expense
(millions of dollars)

	1996	1995	1994	1993
Employer's share of pension benefits earned	82.2	57.8	66.8	85.3
Plus: Pension interest cost	41.0	45.6	73.8	100.0
Less: Amortization of adjustments	(74.8)	(57.0)	(47.0)	(24.6)
Less: Crown agency special payment	(7.5)	(7.3)	(7.1)	(6.7)
Pension expense	40.9	39.1	86.5	154.0

2.118 This exhibit shows the components of the pension expense recorded in the Province's financial statements. It is composed of the employer's cost for the year using the actuarial assumptions, the interest on unfunded amounts, an adjustment to record amortization (of experience gains or losses, changes to actuarial assumptions and plan amendments) and a reduction for special payments by certain Crown agencies.

2.119 Significant amortization adjustments were recorded in the past three years. Dramatic decreases in pension expense resulted in 1994 and 1995 but this trend was not evident in 1996.

2.120 In 1996 there was a large increase in the employer's share of pensions earned. The foregoing exhibit shows this component rose to $82.2 million from $57.8 million in 1995.

2.121 Recording the results of a recent actuarial valuation of the early retirement plan caused the increase in the pension expense. As shown in Note 11 (e) to the financial statements, pension expense recorded for the plan in 1996 was $25.9 million. The corresponding amount for the 1995 year was only $1.6 million.

Timing of future actuarial valuations

2.122 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." Last year the Department of Finance indicated no formal plan was in place to regulate frequency of the valuations.

2.123 However, this year we have been informed that the pension valuation committee is addressing the issue. They plan to recommend a policy in the near future.

Large increase in the liability for the members' plan

2.124 An actuarial valuation was completed for the Members' Superannuation Plan during the 1995-96 year. As a result of this valuation, the pension liability recorded for this plan has risen by $23.4 million to a level of $27.7 million.

2.125 For several years we have expressed our concern that an actuarial evaluation of the pension liability for the Members' Superannuation Plan had not been conducted since 1978. Last year we stated in our annual Report:

> *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.*

2.126 The importance of the valuation is illustrated by the magnitude of the increase in the pension liability.

2.127 Although the increase in the pension liability was $23.4 million, only $2.2 million was recorded in the Province's 1995-96 expenditures. The majority of the increase was shown as an adjustment to the opening balance of net debt. This is consistent with the approach used when the liabilities for the other pension plans were first recorded in the 1993-94 financial statements. The bulk of the adjustment will never be reported as an expense in the Province's financial statements as a result of this retroactive adjustment.

Revenue and expenditure

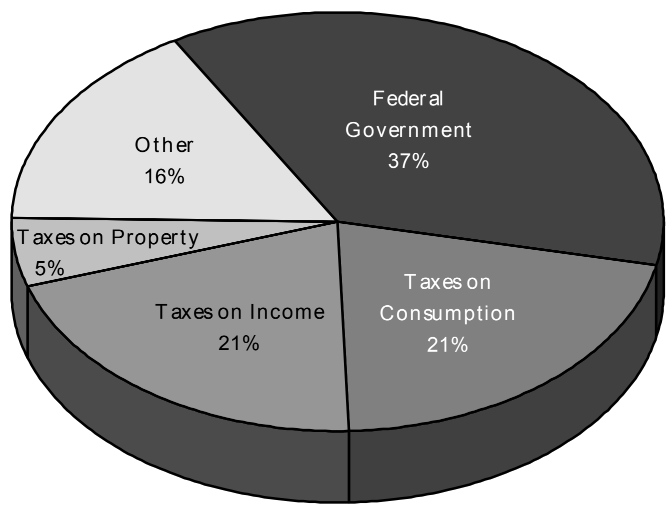
Sources of revenue

2.128 The Province's revenue comes mainly from taxes on consumption, income and property and from federal transfer payments. These combine to account for 84% of total revenue. 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. Also included in provincial revenue is earnings from sinking fund investments.

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

Exhibit 2.7

Sources of revenue



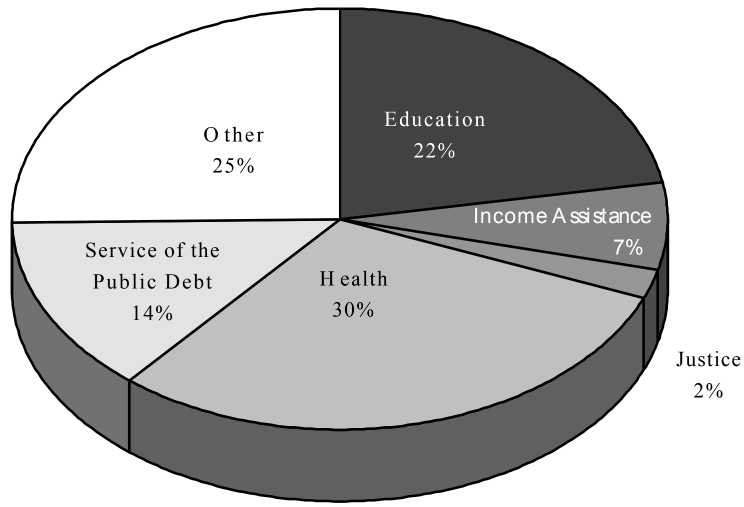
Types of expenditures

2.130 The Province spends the bulk of its resources on social services; namely health, education, income assistance and justice. Spending in this area accounts for 61% of all expenditures. As well, a sizable amount is spent each year to service the public debt. Other areas of expenditure include transportation, economic development, municipal affairs and central government.

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

Exhibit 2.8

Types of expenditures



Actual results compared to the prior year

2.132 The exhibit below illustrates the year-to-year change in revenue, expenditure and surplus or deficit.

Exhibit 2.9

Actual results compared to the prior year (millions of dollars)

	Revenue	Expenditure	Surplus (Deficit)
1996 actual	4,426.7	4,375.6	51.1
1995 actual	4,300.0	4,368.6	(68.6)
Change from prior year	126.7	7.0	119.7

2.133 Actual revenue and expenditure for 1995 has been restated because of the changes in accounting policy outlined in Note 2 to the Province's financial statements. These changes consolidate the Mental Health Commission of New Brunswick and Algonquin Properties Limited in the Province's financial statements and restate the amount of pension expense for the Members' Superannuation Plan. In total, the changes increase the deficit reported last year from $64.0 million to $68.6 million.

2.134 As part of our year-end audit of the Province's financial statements we have identified and analyzed all large or unusual year-to-year fluctuations in both revenue and expenditure accounts. We include here a brief summary of our findings.

Revenue

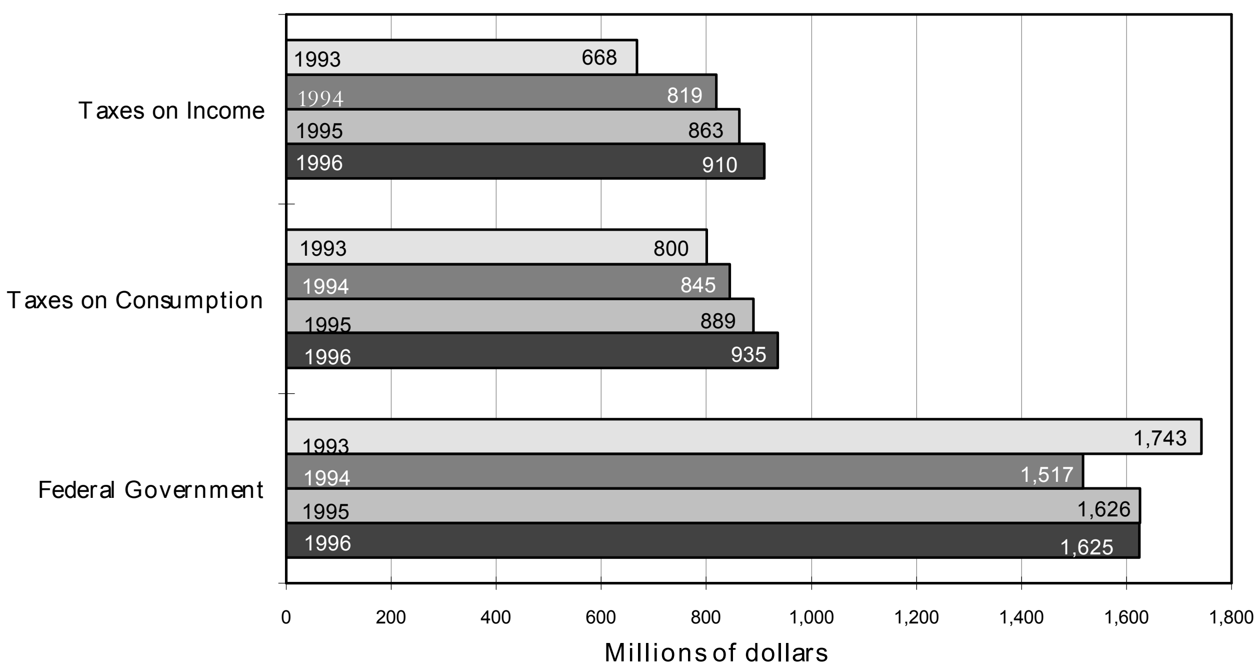
2.135 Taxes on consumption and taxes on income increased by $46.2 million and $47.6 million respectively. In addition, conditional grants from Canada increased by $35.1 million while sinking fund earnings went up by $28.6 million. The increased conditional grants are comprised of an additional $48.0 million for highway improvements less net reductions in other areas totalling $12.9 million.

2.136 These increases were partially offset by a combined decline in fiscal equalization and stabilization payments and established programs financing totalling $36.8 million.

2.137 The following exhibit provides an illustration of the trend occurring in three of the main sources of revenue over the most recent four year period.

Exhibit 2.10

Trends in main sources of revenue



2.138 Federal government transfers now account for 36.7% of total revenue versus 43.5% in 1993. Conversely, combined revenue from taxes has climbed from 42.0% to 47.0% of total revenue in the same period.

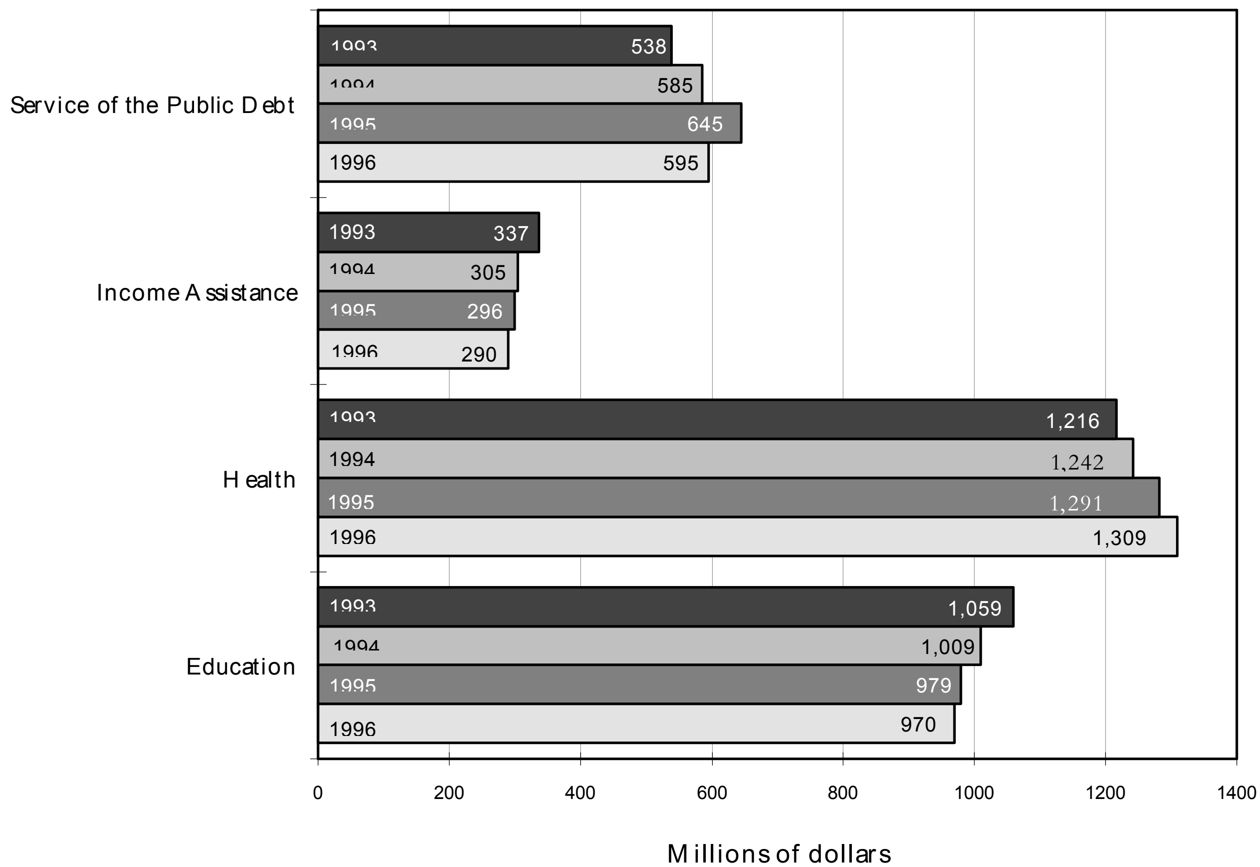
Expenditure

2.139 The largest increases in spending were on transportation and health which rose by $46.8 million and $18.4 million respectively. The increased spending on transportation relates to the additional federal conditional grant monies referred to above. Declines in the cost of servicing the public debt of $49.6 million and spending on social services other than health totalling $17.5 million resulted in a total expenditure relatively unchanged from last year.

2.140 The exhibit below shows the trend for social services and service of the public debt spending over the most recent four-year period.

Exhibit 2.11

Trends in main types of expenditures



2.141 Overall, spending on social services has remained fairly constant, averaging about 61.9% of total expenditures over the four year period. However, the apportionment of that spending has changed such that 49.0% is now spent on health as compared to 45.0% four years ago. While service of the public debt has remained at about 13.7% of total expenditures on average over the past four years, the most recent year marks a reversal of the growth trend previously shown for this expense.

Budgeted results compared to actual results

2.142 The exhibit below illustrates the variation in actual revenue, expenditure and surplus to budgeted amounts.

Exhibit 2.12

Budgeted results compared to actual results (millions of dollars)

	Revenue	Expenditure	Surplus
Budget	4,403.4	4,365.6	37.8
Actual	4,426.7	4,375.6	51.1
Over budget	23.3	10.0	13.3

Revenue

2.143 Although federal conditional grants were higher than expected due to highway funding in excess of budget by $52.5 million, federal source revenue in total fell short of expected levels by $32.1 million. The reason for this is a shortfall of $81.5 million in actual fiscal equalization payments. This was offset in part by taxes on consumption, investment income and sinking fund earnings which exceeded budgeted levels by approximately $18 million each.

Expenditure

2.144 The most significant difference in actual expenditures compared to budget was for transportation which was overspent by $66.0 million, due for the most part to spending on highway improvements. Central government expenses were less than expected by $32.7 million, mostly as a result of pension expense being under budget. In addition, spending on education and service of the public debt fell below anticipated levels by $26.2 million and $23.5 million respectively.

2.145 Overall, revenue and expenditure were over budget by $23.3 million and $10.0 million respectively. This resulted in a surplus that was $13.3 million higher than anticipated.

Special purpose accounts

2.146 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.

2.147 In the seven-year period since the inception of special purpose accounts in 1988-89, the number of accounts has more than tripled bringing the total at present to twenty-nine. The total annual special purpose revenue and expenditure has remained fairly constant, in the $30 - $40 million range, over the six-year period from 1990 to 1996.

2.148 The cumulative balance of the special purpose funds at year end is $16.8 million. Of the $41.0 million in revenue reported for special purpose accounts, $10.8 million (26%) is from lottery revenue, $9.6 million (24%) is from contract training fees, $5.0 million (12%) is from land sales and $4.2 million (10%) is from federal grants.

2.149 New special purpose accounts have been established this year for the Kingsbrae Horticultural Garden, the Biotechnology Fund, Redevelopment of the Miramichi Region, Public/Private Partnership Projects, Renovation of Old Government House and the National Safety Code Agreement.

Deferral of special purpose revenue

2.150 Funding received within two of these special purpose accounts has not been included in revenue for the year. It has been deferred and will be recognized as revenue in future periods when the funds are expended for their intended purpose.

2.151 The Province entered into an agreement, effective 31 March 1996, with the federal government whereby a payment of $10.3 million was received to assist in diversifying and assisting the economy of the Miramichi area upon closure of CFB Chatham. The amount received has been recorded as deferred revenue in the Province's financial statements.

2.152 Another agreement between the Province, the Government of Canada and the City of Fredericton pertaining to restoration of Old Government House resulted in the receipt of a $4.0 million federal payment during the year. This too has been recorded as deferred revenue in the Province's financial statements.

Surpluses, deficits, borrowing and net debt

2.153 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 surplus or deficit, 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 or any of the other organizations which make up the provincial reporting entity.

Definitions

2.154 The following definitions explain terms used in the Province's annual financial statements. These terms together with the corresponding balances constitute important financial information. Our annual Reports attempt to place some of this data in perspective by providing comparative information. Such comparisons are useful in that the reader may better understand the Province's financial history, current status and future goals.

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

2.156 The **surplus** in a fiscal year is the excess of the Province's total revenue over its total expenditure. (A **deficit** is the excess of total expenditure over total revenue.) Total revenue consists mainly of taxes and federal transfer payments. Total expenditure includes 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.

2.157 The **cost of servicing the public debt** is a major component of annual expenditure. 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.

2.158 **Funded debt** is the total long-term borrowing by the Province. **Funded debt for provincial purposes** excludes borrowing on behalf of NB Power Corporation and usually occurs when the Province's cash inflows are not sufficient to meet its obligations. Long term borrowing usually takes the form of provincial bonds, but it may also include debt issued to the Canada Pension Plan. The debt issued to the Canada Pension Plan accounts for sixteen percent of the Province's debt. This level is consistent with prior years.

2.159 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.

2.160 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 instalments 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.

2.161 Annual surpluses and 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 gross amount of long-term borrowing undertaken by the Province. Net debt is comparable to an accumulated deficit balance which private sector companies would disclose in the owners' equity section of their balance sheet. Net debt is the funded debt and other liabilities of the Province minus assets which can be used by the Province to fulfil its obligations. Therefore, net debt shows the shortfall in resources should all the liabilities of the Province come due at the fiscal year end. It represents the amount of future revenue required to pay for past transactions.

2.162 This chapter of our Report provides the following financial indicators on a comparative basis:

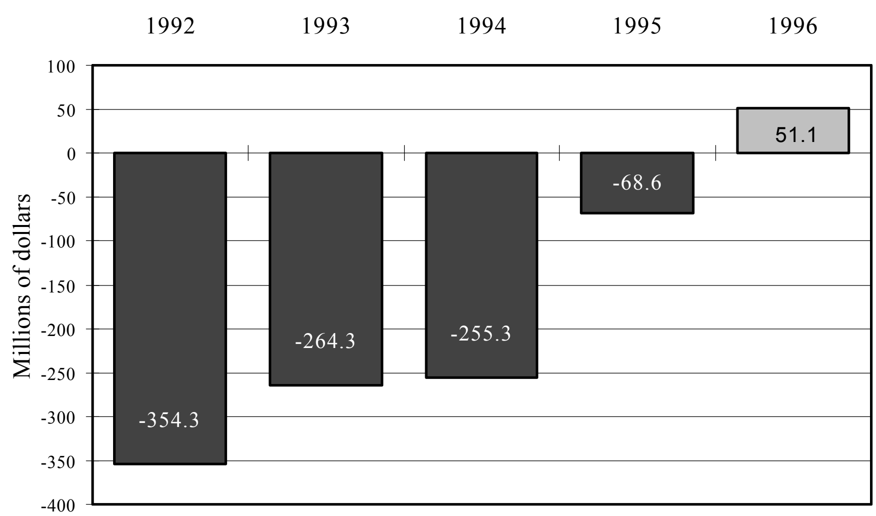
- Surplus (Deficit) per person and employed person in New Brunswick;
- Cost of borrowing per person and employed person in New Brunswick;
- Proportion of Provincial revenue consumed by cost of servicing the public debt;
- Comparison of the level of funded debt to the level of sinking fund investments;
- Comparison of New Brunswick's foreign borrowing activity compared to that of the other Atlantic provinces; and
- GDP as a proportion of net debt.

Surplus for the year ended 31 March 1996

2.163 The Province had a surplus for the year ended 31 March 1996 of $51.1 million. This was the first such surplus in the last five years. This amount includes the surpluses and deficits of the government enterprises described in Note 1 of the Province's financial statements. Exhibit 2.13 shows the amount of the Province's surplus or deficit for each of the last five years. The prior years' figures have been restated to conform with the current year's presentation.

Exhibit 2.13

Provincial surplus or deficit for the last five years



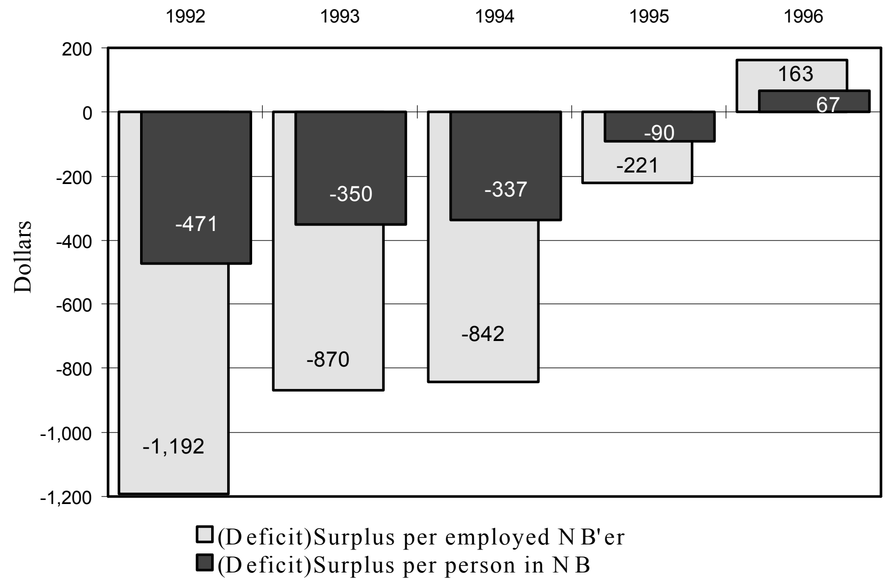
2.164 The 1995-96 surplus translates to a $67 share for each person living in New Brunswick[1]. This is in contrast to last year's (restated) deficit of $90 per person[2].

2.165 Examining the surplus from the perspective of an average employed New Brunswicker might provide a better measure of its size. Exhibit 2.14 shows the amount of the surplus or deficit per person and per the average number of employed persons in each of the last five years.

1. Population as at 31 March 1996 per N.B. Statistics Agency.
2. Population as at 31 March 1995 per N.B. Statistics Agency.

Exhibit 2.14

Provincial surplus or deficit per person for the last five years



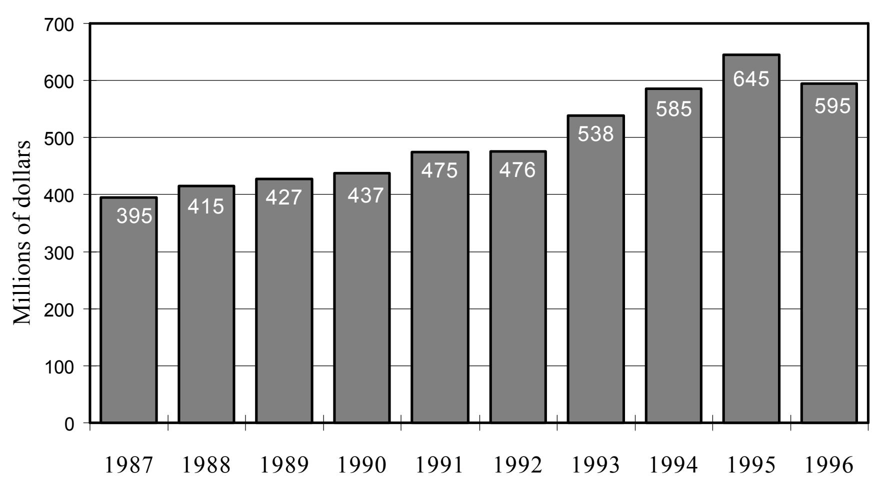
Cost of servicing the public debt

2.166 Since the Province has not always had sufficient funds from revenue to cover all expenditures, including the interest incurred on public debt, funds had to be borrowed to ensure the Province's obligations were 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.

2.167 Exhibit 2.15 shows the cost of servicing the public debt by year for the last ten years.

Exhibit 2.15

Cost of servicing the public debt for the last ten years

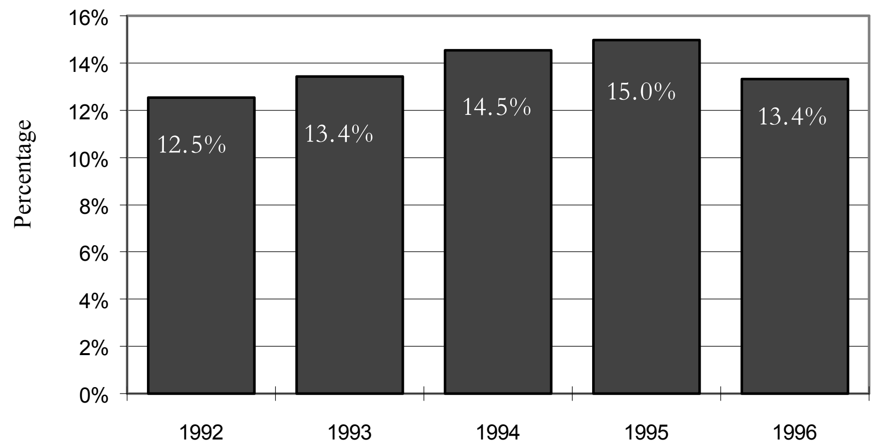


2.168 During this period the cost of servicing the public debt has risen from a low of $395 million to a high of $645 million in 1994-95. This represents an increase of 63.3% over nine years. For the first time in ten years, the cost of servicing the public debt has decreased. It fell to $595 million in 1995-96, a decrease of 7.7% from 1994-95.

2.169 Exhibit 2.16 shows the portion of provincial revenue consumed by the cost of the public debt for the last five years.

Exhibit 2.16

Portion of provincial revenue consumed by the cost of the public debt for the last five years



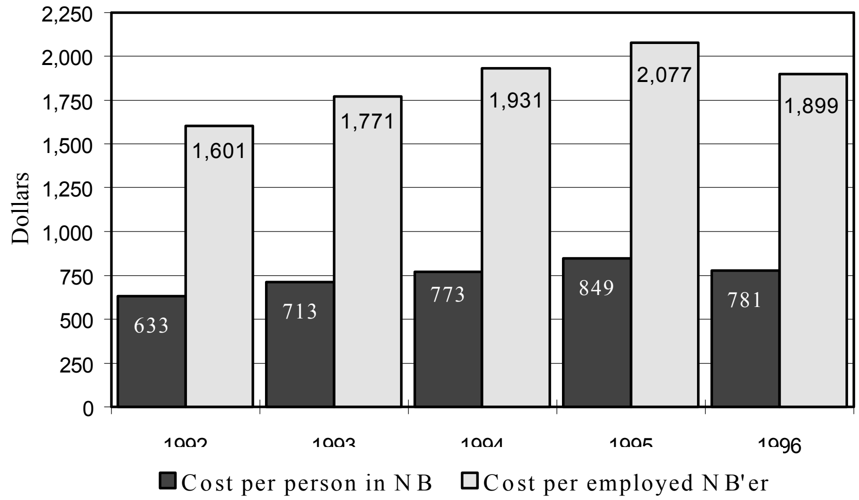
2.170 The decrease from 15.0% in 1994-95 to 13.4% in 1995-96 is the net result of a decrease in borrowing costs of $50 million combined with an increase in revenue of approximately $127 million. The lower borrowing costs resulted chiefly from a decrease in foreign exchange expense. The higher revenue was mostly due to an increase in consumption tax and income tax revenue. If 1995-96 revenue had remained at the prior year's level, the percentage consumed by the cost of borrowing would still have decreased to 13.8%.

2.171 This year's cost of borrowing translates to $781 for each person living in New Brunswick[1]. Expressed another way, the Province's cost of borrowing for 1995-96 averages $1,899 for each employed New Brunswicker[2]. Exhibit 2.17 shows this relationship for the last five years.

1. Population as at 31 March 1996 per N.B. Statistics Agency.
2. Employment figures based on annual average for fiscal 1996. Data supplied by N.B. Statistics Agency.

Exhibit 2.17

Provincial cost of borrowing per person for the last five years

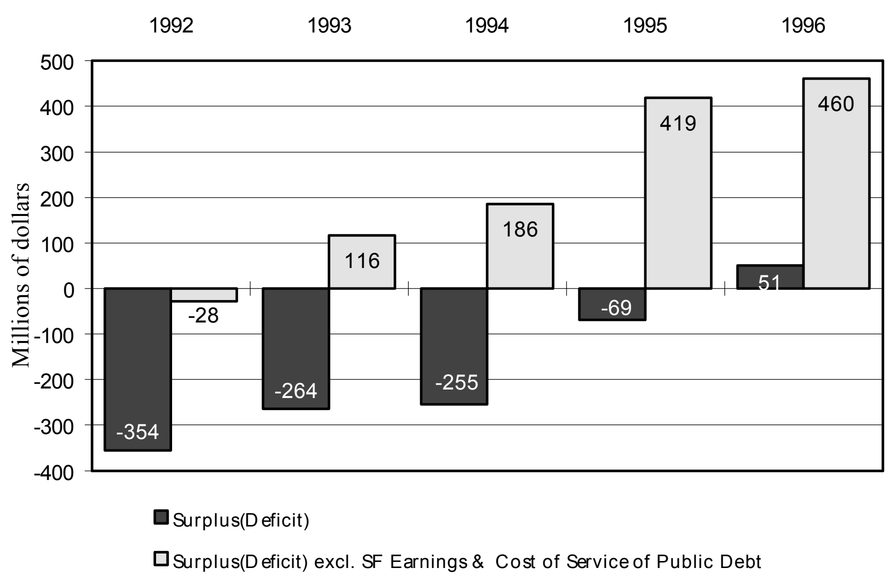


2.172 If the Province had not been required to borrow funds in previous years, then there would not exist either the significant cost of servicing the public debt nor interest revenue from the Province’s sinking fund. If these items were excluded (other factors remaining the same), the current year would have shown a surplus of approximately $460 million.

2.173 Exhibit 2.18 demonstrates that the Province would have shown significant surpluses in four of the past five years had there been no cost of servicing the public debt or sinking fund earnings.

Exhibit 2.18

Provincial surplus or deficit for the last five years excluding cost of servicing the public debt and sinking fund earnings



Funded debt for provincial purposes

Surpluses and repayment of long and short-term borrowing

2.174 There is not always a direct relationship between the level of annual surpluses or deficits and the ability of the Province to repay or incur debt. Surpluses and deficits are accounting terms used to describe the difference between a current year's revenue and expenditure. Revenue is 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.

2.175 These actual cash flows, as disclosed in the Province's Statement of Cash Flows, dictate the extent to which the Province is able to repay funds during the year. Note 16 to the Province's financial statements focuses on both long and short-term borrowing. It explains that the Province was able to reduce borrowing by $101 million in 1995-96 despite a surplus of only $51.1 million.

2.176 The components of this $101 million decrease in borrowing are bank advances and short term borrowing (which increased by $40.3 million), long-term borrowing (which increased by $19 million) and sinking fund investments (which increased by $160.3 million). Stated another way, the decrease in borrowing is due to the growth in sinking fund investments which exceeded and offset the growth in the long and short-term borrowing of the Province in the year.

Long-term borrowing activity in the current year

2.177 In the past year, provincial bonds were sold for periods ranging from two to twenty years. Exhibit 2.19 summarizes the activity in the funded debt for provincial purposes account during the last five years.

Exhibit 2.19

Funded debt for provincial purposes for the last five years

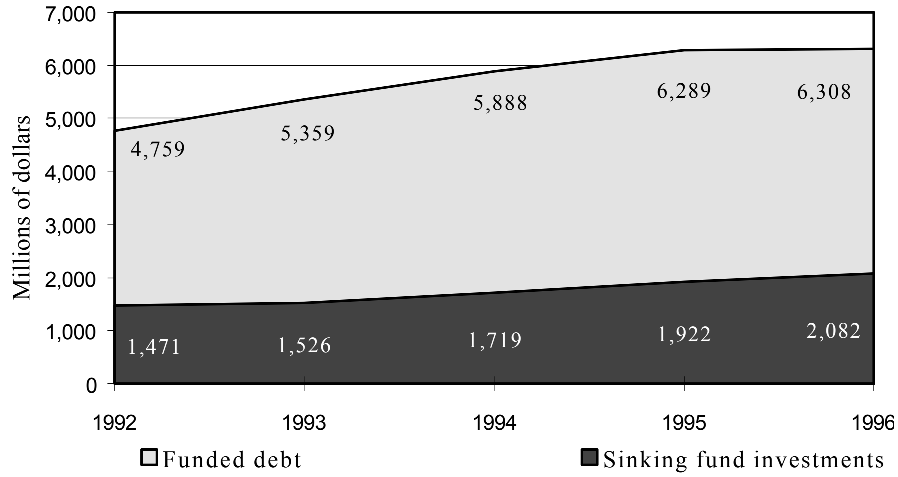
	1996	1995	1994	1993	1992
Opening balance	6,288.8	5,887.6	5,358.5	4,758.7	4,574.7
Borrowed during the year	698.1	708.0	634.3	949.1	643.7
Debt redeemed	(543.9)	(412.1)	(278.2)	(427.6)	(473.6)
Adjustment for the change in exchange rates	(135.2)	105.3	173.0	78.3	13.9
Closing balance	6,307.8	6,288.8	5,887.6	5,358.5	4,758.7

2.178 The increase in total funded debt for provincial purposes during the year is offset by the increase in investments of the sinking fund. During the year ended 31 March 1996 debt increased by $19 million while the compensating increase in the sinking fund investments was $160.3 million.

2.179 Exhibit 2.20 shows the relationship between funded debt for provincial purposes and sinking fund investments for the last five years.

Exhibit 2.20

Funded debt for provincial purposes compared to sinking fund investments for the last five years



Exposure to foreign currency exchange rate fluctuations

2.180 Debt repayable in foreign currencies is denominated in US dollars, Japanese yen and Swiss francs. Between 1 April 1995 and 31 March 1996 the Canadian dollar increased in value against all of these currencies. The net result was a favourable adjustment of $135.2 million. This gain will be recorded in the accounts of the Province as a reduction in expenditures over the remaining life of the related debt. The adjustment for the change in exchange rates has reduced the amount of the provincial debt this year. In contrast, the adjustment for change in exchange rates has increased the amount of the provincial debt in each of the previous four years.

2.181 Exhibit 2.21 summarizes the exposure of the Province to foreign exchange rate fluctuations over the past five years.

Exhibit 2.21

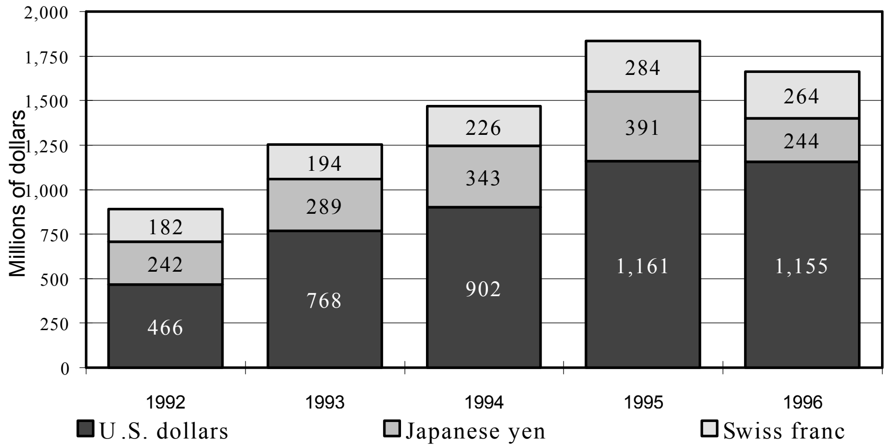
Debt payable in foreign currencies for the last five years

	1996	1995	1994	1993	1992
Debt payable in foreign currencies	1,904.4	1,953.7	1,555.6	1,307.5	1,135.0
Less: Foreign issues with fixed exchange rates					23.3
Less: Investment in foreign currencies	242.0	117.7	85.5	56.0	222.1
	1,662.4	1,836.0	1,470.1	1,251.5	889.6
Percentage of total debt	26.4%	29.2%	25.0%	23.4%	18.7%

2.182 Exhibit 2.22 demonstrates the change in the Province’s exposure to foreign currencies, and the components of that exposure, for each of the last five years.

Exhibit 2.22

Changes in debt payable in foreign currencies for the last five years



2.183 Exhibit 2.21 shows that exposure to gains and losses due to foreign currency exchange rate fluctuations at 31 March 1996 has decreased by $173.6 million from 31 March 1995.

2.184 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 foreign currency at a stipulated price on a specified future date).

2.185 Note 10 of the financial statements of the Province discloses the debt that is repayable under swap agreements. This debt is excluded from the above exhibits except where the debt was payable in US dollars under a swap agreement.

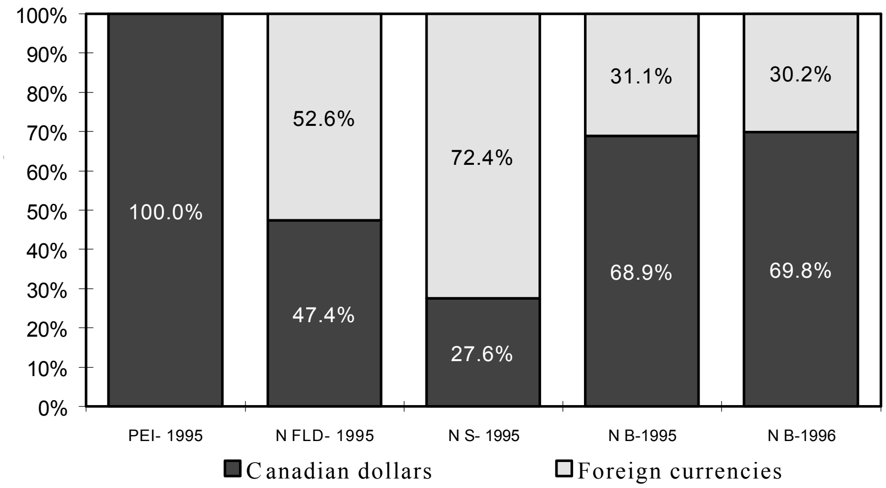
2.186 At 31 March 1996, the Province had one outstanding forward contract which fixed exchange rates on an exposure of approximately $8 million.

Total borrowing in a foreign currency

2.187 Exhibit 2.23 compares the total foreign currency borrowing of the Province to the other Atlantic Provinces at 31 March 1995. (The two preceding illustrations focused on net exposure after considering foreign currency investments.) This is the latest year for which all information is available. The Province’s borrowing as at 31 March 1996 is also provided in this exhibit for comparative purposes.

Exhibit 2.23

Canadian and foreign currency borrowing of Atlantic Provinces at 31 March 1995



Net debt at 31 March 1996

2.188 As noted previously, net debt decreased by $51.1 million during the 1995-96 year. The amount of net debt at 31 March 1996 stands at $7,244 per person[1] living in New Brunswick or approximately $17,617 for each employed person[2] in New Brunswick. The average wage of a New Brunswicker was $26,493[3] during 1995-96.

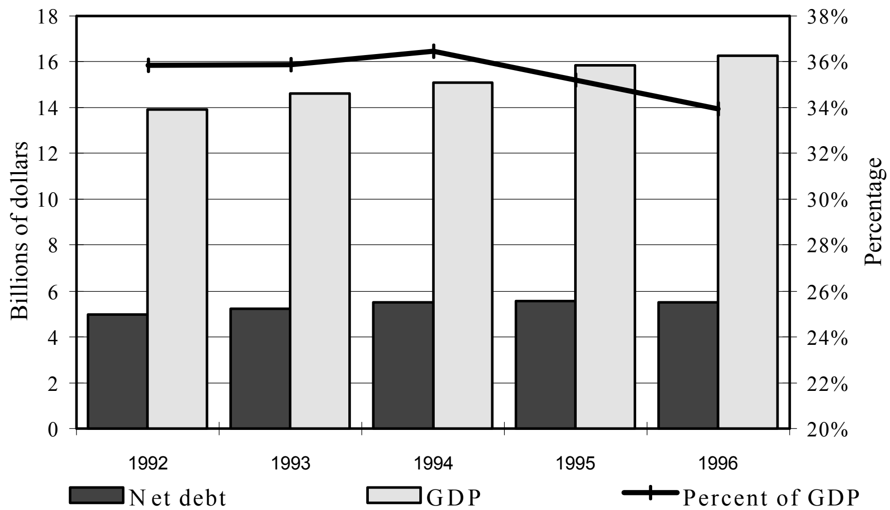
2.189 Net debt as a percentage of gross domestic product (GDP) is frequently used to measure a government's ability to sustain its debt. GDP is a measure of the current market value of all goods and services produced in the Province during a year. The market value used in the calculation includes taxes (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 34%.

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

1. Population as at 31 March 1996 per N.B. Statistics Agency.
2. Employment figures based on annual average for fiscal 1996. Data supplied by N.B. Statistics Agency.
3. Average wage figures based on annual average for fiscal 1996. Data supplied by N.B. Statistics Agency.

Exhibit 2.24

Provincial net debt and GDP for the last five years



Note: 1996 GDP estimate and historical GDP information obtained from N.B. Statistics Agency

2.191 The net debt to GDP ratio showed a modest decrease in 1995-96. Our Office reported a net debt to GDP ratio of 35% in last year's Report. This is the second consecutive year that the ratio has decreased. 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

2.192 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.

2.193 The government would need surpluses of $276 million per year for a period of twenty years to eliminate its existing net debt.

2.194 As discussed elsewhere in this Report, the Province has met its balanced budget legislation by achieving an overall surplus in the ordinary account over three years. However, 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 expenditure, including the capital account, does not exceed total revenue during each four year period subsequent to 31 March 1996.

Summary

2.195 Exhibit 2.25 summarizes the impact of the Province's current financial results from the perspective of a resident of the Province of New Brunswick.

Exhibit 2.25

Summary of provincial financial results

	Per person in N.B.		Per employed person in N.B.	
	1996	1995	1996	1995
Borrowing Cost	781	849	1,899	2,077
Surplus (Deficit)	67	(90)	163	(221)
Net Debt	7,244	7,335	17,617	17,952

2.196 We will continue in our attempt to provide understandable information on the Province's surpluses, 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.