Chapter 2 Comments on the Province's Financial Position

Contents

Comments on the Province's Financial Position

Signs of Change…

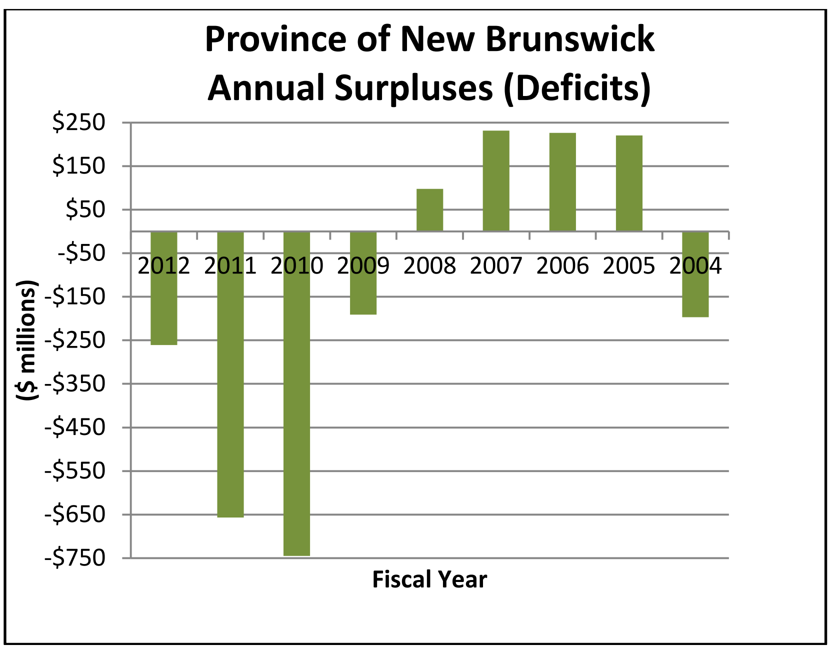
2.1 The Province's 31 March 2012 audited financial statements reported a deficit of $260.6 million and an increase in Net Debt for the fiscal year of $430.1 million. The Province now has a Net Debt of over $10 billion.

2.2 We are encouraged by the fact that the $260.6 million annual deficit was less than the budgeted deficit of $448.8 million and was less than the prior year deficit of $657.0 million. Also, the growth of Net Debt has slowed this year.

…but Continued Deficits

2.3 However, it is still the fourth consecutive annual deficit. To assist in financing these deficits, the Province has incurred additional debt. This trend is very concerning. Continued changes are required to improve the financial health of the Province.

Table 2.1 - Annual Surpluses (Deficits)



As restated

Table 2.2 - Annual Surpluses (Deficits) data

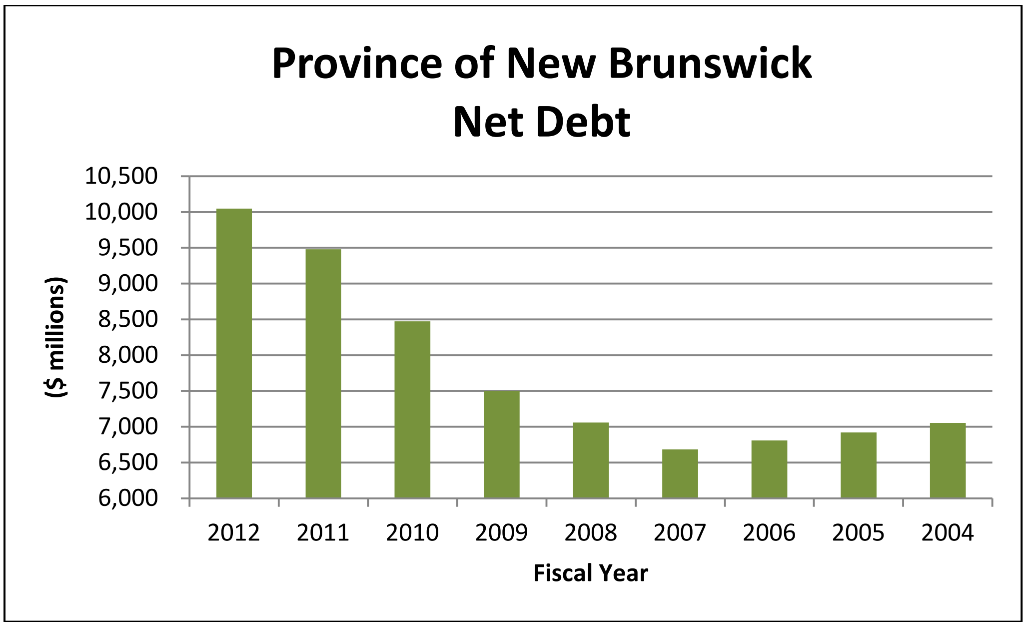
Annual Surpluses (deficits) ($ millions)									
	2012	2011	2010	2009	2008	2007	2006	2005	2004
As restated		(657.0)	(744.8)	(190.8)	97.4	231.7	226.3	220.5	(196.7)
As originally recorded	(260.6)	(633.0)	(737.9)	(192.3)	86.7	236.8	243.6	242.2	(103.2)

2.4 Tables 2.1 and 2.2 show the surplus or deficit for the past nine years. The preceding years' amounts have been restated as per Note 19 of the Province's 31 March 2012 financial statements.

Continued Growth in Net Debt

2.5 Net Debt is one of the most important measures of the financial position of the Province. Tables 2.3 and 2.4 show Net Debt for the past nine years.

Table 2.3 - Net Debt



As restated

Table 2.4 - Net Debt Data

Net Debt ($ millions)									
	2012	2011	2010	2009	2008	2007	2006	2005	2004
As restated		9,615.7	8,582.7	7,590.2	7,132.2	6,739.6	6,853.6	6,948.2	7,067.2
As originally recorded	10,045.8	9,480.4	8,353.0	7,387.8	6,942.9	6,577.9	6,655.7	6,836.0	6,816.1

2.6 We would like to draw attention to the following facts:

- For the year ended 31 March 2012, Net Debt increased by $430.1 million to $10 billion.
- Net Debt has increased $3.3 billion since 2007.
- The 2012-2013 Main Estimates budgets for an increase in Net Debt of $738.9 million for the year ended 31 March 2013. We understand approximately half of this amount includes a onetime payment for Route 1 Gateway Project.
- Based on 2012-2013 Main Estimates, Net Debt of the Province could be in excess of $10.5 billion for the year ended 31 March 2013.

2.7 This continued increase in Net Debt represents a very disturbing trend. An even higher demand will exist on future revenue to pay past expenses. Such continued negative trends impacted the Standard & Poor's decision to downgrade the Province's bond rating from AA- to A+ in 2012. This will ultimately result in more expensive borrowing cost. As well, New Brunswick's increased borrowing may constrain future borrowing capacity and affect future provincial operations and delivery of services.

Comparison to Other Similar Sized Provinces

2.8 Another way to assess the significance of the size of the Province's Net Debt is to compare it to the Net Debt of provinces with similar populations as New Brunswick in absolute amount, per capita and as a percentage of GDP. Comparable provinces include Nova Scotia, Manitoba and Saskatchewan.

2.9 In the next three tables data is taken from:

- the audited summary financial statements of the individual provinces,
- information about population is taken from the Statistics Canada website, and
- GDP figures are from the financial statement discussion and analysis attached to the individual provinces' audited summary financial statements.

Table 2.5 - Net Debt Comparison to Provinces of Similar Size

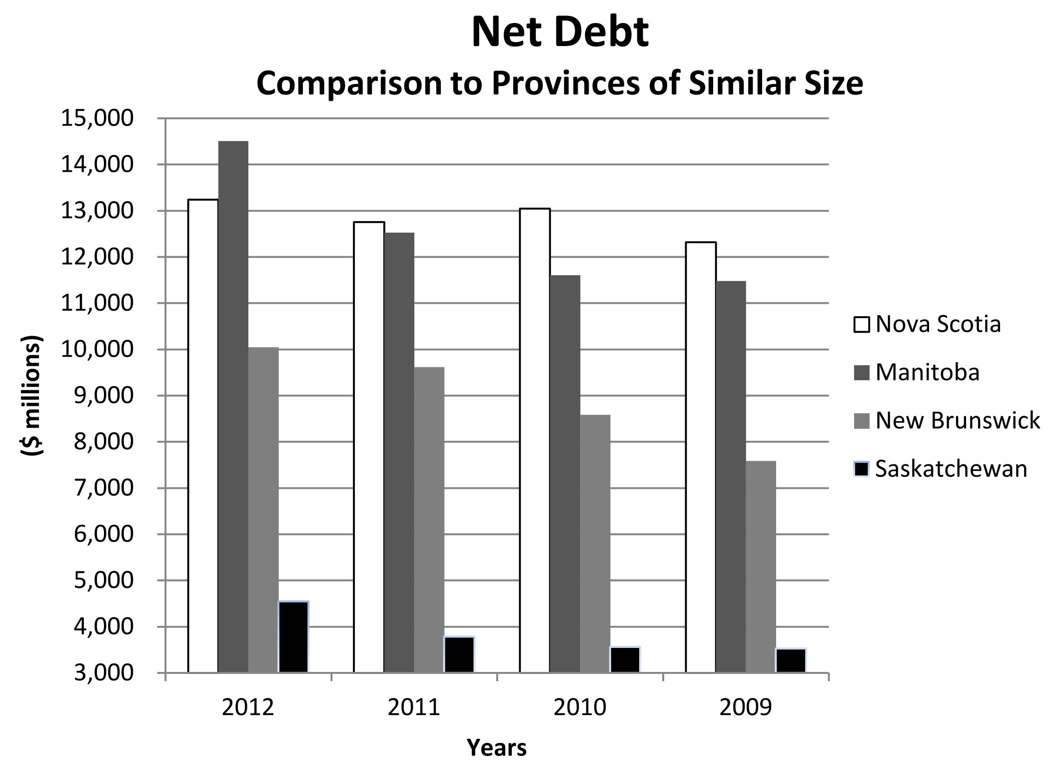


Table 2.6 - Net Debt Comparison to Provinces of Similar Size (data)

Net Debt ($ millions)						
Province	**Increase 2009 to 2012**	**Increase 2011 to 2012**	**2012**	**2011**	**2010**	**2009**
New Brunswick	32%	4%	10,046	9,615	8,583	7,590
Saskatchewan	29%	20%	4,543	3,783	3,560	3,524
Manitoba	26%	16%	14,511	12,525	11,607	11,480
Nova Scotia	7.5%	4%	13,243	12,758	13,045	12,318

2.10 Table 2.6 shows that over the last four years within this comparable group, New Brunswick has had the highest increase in Net Debt. New Brunswick's Net Debt has increased by 32% over the last four years. The magnitude of this increase is concerning. We are, however, very pleased to note that the rate of Net Debt growth has slowed in the past year. New Brunswick Net Debt grew only 4.3% in fiscal 2012. Still, the overall debt burden for the Province remains at an elevated level with no signs of a reduction in the coming year given the 2012-2013 Main Estimates, which budgets an increase in Net Debt of approximately $740 million. We are concerned at the long term implications and borrowing cost of the current debt load.

Table 2.7 - Net Debt Per Capita

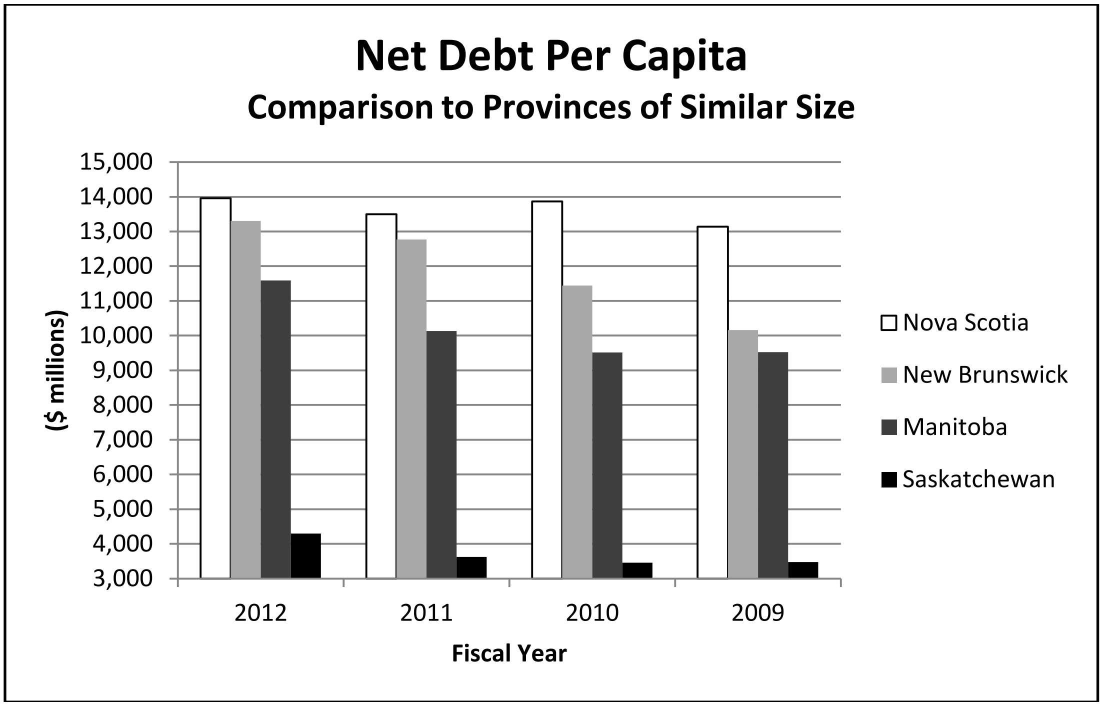


Table 2.8 - Net Debt Per Capita (data)

Net Debt Per Capita* ($)				
Province	**2012**	**2011**	**2010**	**2009**
Nova Scotia	13,962	13,498	13,869	13,139
New Brunswick	13,301	12,771	11,446	10,162
Manitoba	11,593	10,136	9,515	9,521
Saskatchewan	4,295	3,622	3,458	3,476

* *Using populations from Statistics Canada as of July 1 within the fiscal year (i.e. 2012 uses July1,2011 population), numbers have been rounded for presentation purposes.*

2.11 Information in Table 2.8 shows that New Brunswick has the second highest Net Debt per capita in the comparable group. If the debt were to be eliminated by way of contributions from New Brunswickers, each would contribute approximately $13,000. Again, this is an indicator that has increased significantly from 2009 at $10,162 to 2012 at $13,301.

2.12 For the year ended 31 March 2009, New Brunswick's Net Debt per capita was 77.3% of Nova Scotia's Net Debt per capita. By 31 March 2012 the percentage reached 95.3%.

Table 2.9 - Net Debt as a Percentage of GDP

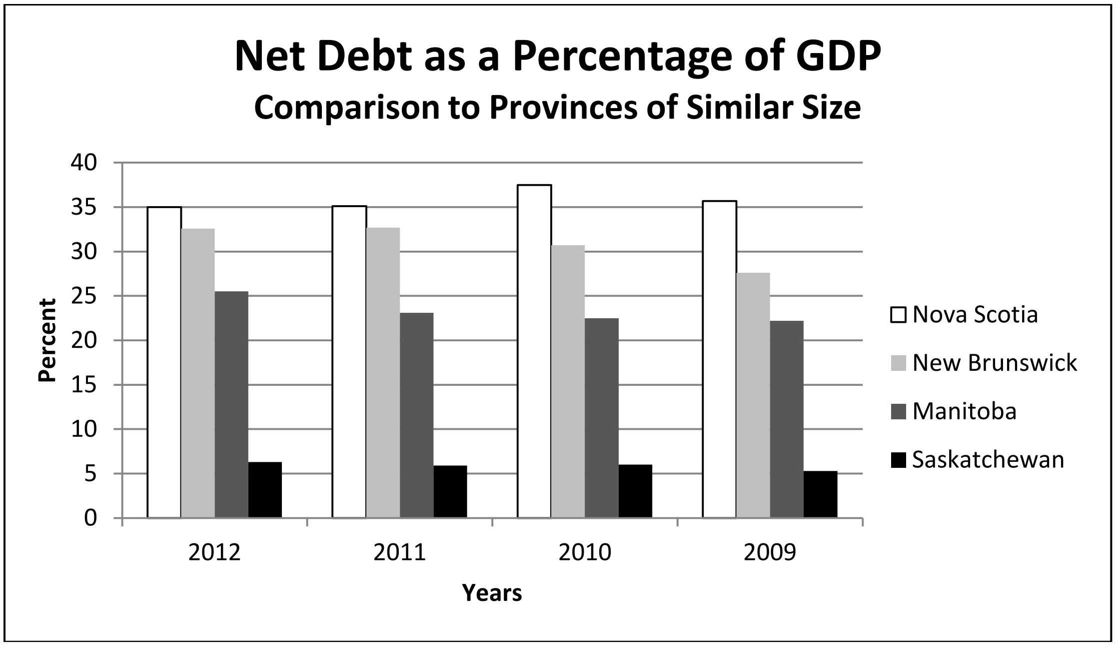


Table 2.10 - Net Debt as a Percentage of GDP (data)

Net Debt as a percentage of GDP (percent)					
Province	**2012**	**2011**	**2010**	**2009**	**% Increase from 2009 to 2012**
Nova Scotia	35.0	35.1	37.5	35.7	(2%)
New Brunswick	32.6	32.7	30.7	27.6	18%
Manitoba	25.5	23.1	22.5	22.2	15%
Saskatchewan	6.3	5.9	6.0	5.3	19%

2.13 As shown in Table 2.10, New Brunswick had the second highest increase of Net Debt as a percentage of GDP from 2009 to 2012, and the second highest

Net Debt as a percentage of GDP among comparable provinces for 2012. For the year ended 31 March 2009, New Brunswick's Net Debt as a percentage of GDP was 77.3% of Nova Scotia's; for the year ended 31 March 2012 it was 93.1%.

Net Debt Comparison Summary

2.14 New Brunswick's Net Debt performance compared to other provinces remains a significant concern. New Brunswick's increase in Net Debt of $3.3 billion from 2007 indicates the need for continued efforts to address the level of Net Debt.

Comments on the Province's Financial Health

2.15 For the past number of years, we included in our annual Report a historical trend analysis of the Province's financial condition by looking at measures of sustainability, flexibility and vulnerability.

2.16 Starting in 2009, the Province began reporting some of these measures as part of the section called *Indicators of Financial Health* which is reported in Volume 1 of Public Accounts. As we commented last year, we are pleased to see the Province report this information, and we are also pleased to see that for 31 March 2012 the Province expanded the historical timeframe of information provided from eight years to nine years.

2.17 In this section, we report on twelve indicators of financial condition identified by the Canadian Institution of Chartered Accountants (CICA) in a Statement of Recommended Practice (SORP). This analysis is intended to give a broader view of the financial health of the Province as the analysis shows trends. The analysis expands on the information reported in the audited financial statements which only reflect the Province's fiscal status at a point in time.

Assumptions Used

2.18 We have not audited some of the numbers used in our indicator analysis; instead, we are using numbers the Province restated as per Note 19 of the Province's financial statements. The Province used these restated figures in its Management Discussion and Analysis in Volume 1 of Public Accounts. We have not audited the annualized numbers we obtained from the Province for the years 2004 to 2010. For the 2011 and 2012 numbers, we audited the numbers as part of our

2012 work.

2.19 In some of the tables that follow, we show five years of comparative figures instead of nine. For these cases, restated numbers for prior years are not available because of changes in accounting policies.

Summary of the Province's Financial Condition

2.20 In the following table, we summarize our analysis of financial indicators. We show the indicators for each element, the purpose of the indicator, the short-term (two year) and long-term (five or nine year) trend, as well as a reference within this chapter of where we discuss the indicator in more detail.

Table 2.11 - Summary of Financial Indicators

	Indicator	Purpose	Short-term Trend	Term	Long-term Trend	Page
Sustainability	Assets-to-liabilities	Measures extent that government finances its operations by issuing debt	Neutral*	5 year	Unfavourable	18
	Financial asset-to-liabilities	Measures whether future revenues will be needed to pay for past transactions	Neutral*	5 year	Unfavourable	19
	Net Debt-to-total annual revenue	Shows whether more time is needed to pay for past transactions	Unfavourable	9 year	Unfavourable	20
	Expense by function-to-total expenses	Shows the trend of government spending over time	Neutral	5 year	Neutral	21
	Net Debt-to-GDP	Shows the relationship between Net Debt and the activity in the economy	Unfavourable	9 year	Unfavourable	22
	Accumulated deficit–to-GDP	Measures the sum of the current and all prior year operating results relative to the growth in the economy	Unfavourable	5 year	Unfavourable	22
	Total expenses-to-GDP	Shows the trend of government spending over time in relation to the growth in the economy	**Favourable***	9 year	Unfavourable	23
Flexibility	Public debt charges-to-revenues	Measures extent that past borrowing decisions limits ability to meet current financial and service commitments	Neutral	9 year	**Favourable**	25
	Net book value of capital assets-to-cost of capital assets	Measures the estimated useful lives of tangible capital assets available to provide products /services	Neutral	5 year	Neutral	26
	Own-source revenues-to-GDP	Measures extent income is taken out of the economy	Neutral	9 year	Neutral	27
Vulnerability	Government transfers-to-total revenues	Measures the dependence on another level of government	**Favourable***	9 year	Mixed	30
	Foreign currency debt-to-Net Debt	Measures the government's potential vulnerability to currency fluctuations	**Favourable**	9 year	**Favourable**	31

**Notes a change from prior year*

Conclusion

2.21 The long-term trends show the financial condition of the Province has remained relatively unchanged since the prior year, however, there have been signs of short term improvement in certain areas. In particular, we note our assessment of four short-term indicators has improved over the prior year due to the progress evidenced through the reduction in the annual deficit and slowing of the growth of Net Debt. We are encouraged to see these signs of improvement.

2.22 However, there has not been enough progress to date to cause a shift in long-term indicator assessments. We remain concerned about the level of Net Debt, now over $10 billion. With the anticipated increase in Net Debt as per 2012-13 Main Estimates of approximately $740 million, New Brunswick Net Debt growth since 2007 will have increased by 60%. This pace of Net Debt growth is not sustainable in the long term, and significant changes will be required to address this problem. It may eventually impact the Province's ability to meet its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others.

2.23 Government's announced plan of returning to balanced budgets by 2014-15 is welcome news, however, we would also encourage a similar long term commitment from government with respect to decreasing Net Debt.

Sustainability Indicators

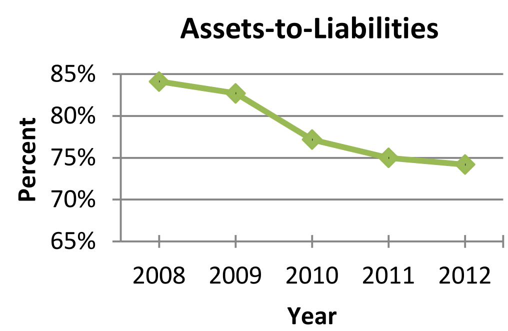
2.24 Sustainability indicates whether the Province can maintain programs and meet existing creditor requirements without increasing the debt burden on the economy.

Assets-to-Liabilities

2.25 The sustainability indicator assets-to-liabilities is presented in Table 2.12.

Table 2.12 - Comparison of Assets-to-Liabilities

Comparison of Assets-to-Liabilities				
Year ended	Total assets ($ millions)	Total liabilities ($ millions)	Total assets/ total liabilities (percent)	
2008	7,906.3	9,399.0	84.1%	
2009	8,659.8	10,470.9	82.7%	
2010	8,630.0	11,181.0	77.2%	
2011	9,305.1	12,402.6	75.0%	
2012	9,706.3	13,074.3	74.2%	



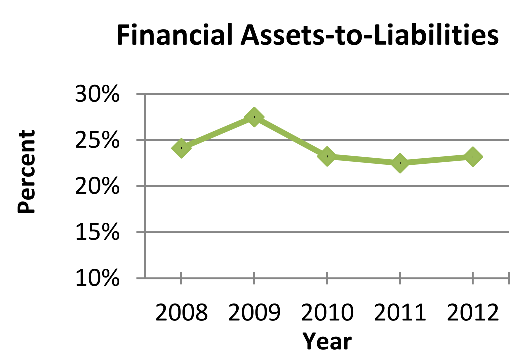
2.26 An assets-to-liability indicator below 100% indicates a government has accumulated deficits and has been financing its operations by issuing debt. For the past five years, the Province's rate was less than 100%. It has dropped slightly in the short term and has decreased over the long term. This trend is unfavourable.

Financial Assets-to-Liabilities

2.27 Another sustainability indicator, financial assets-to-liabilities, is presented in Table 2.13.

Table 2.13 - Comparison of Financial Assets-to-Liabilities

Comparison of Financial Assets-to-Liabilities				
Year ended	Total financial assets ($ millions)	Total liabilities ($ millions)	Total financial assets/ total liabilities (percent)	
2008	2,266.8	9,399.0	24.1%	
2009	2,880.7	10,470.9	27.5%	
2010	2,598.3	11,181.0	23.2%	
2011	2,786.9	12,402.6	22.5%	
2012	3,028.5	13,074.3	23.2%	



2.28 When liabilities exceed financial assets the government is in a Net Debt position, and the implication is that future surpluses will be required to pay for past transactions and events. The Province's percentage declined in the year ended 31 March 2011 because of the large increase in liabilities. The percentage did show improvements in 2012. We have assessed the short-term trend as neutral and the long-term trend as unfavourable.

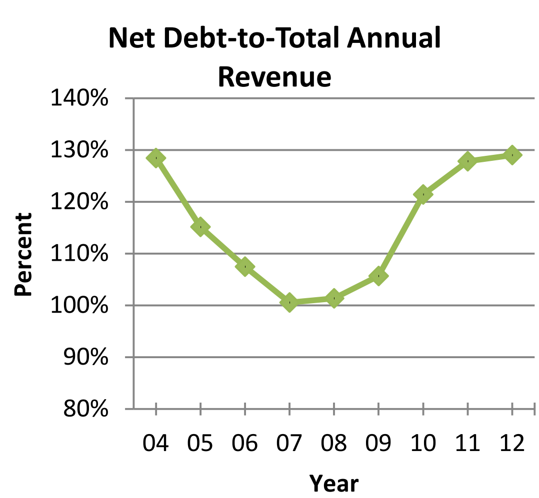
Net Debt-to-Total Annual Revenue

2.29 Net Debt-to-total annual revenue is another indicator of sustainability and is presented in Table 2.14.

Table 2.14 - Comparison of Net Debt-to-Total Annual Revenue

Comparison of Net Debt-to-Total Annual Revenue

Year ended	Net Debt ($ millions)	Total revenue ($ millions)	Net Debt/ total revenue (percent)
2004	7,067.2	5,503.3	128.4%
2005	6,948.2	6,034.8	115.1%
2006	6,853.6	6,378.0	107.5%
2007	6,739.6	6,703.5	100.5%
2008	7,132.2	7,037.8	101.3%
2009	7,590.2	7,184.0	105.7%
2010	8,582.7	7,070.4	121.4%
2011	9,615.7	7,521.4	127.8%
2012	10,045.8	7,789.0	129.0%



2.30 Net Debt provides a measure of the future revenue required to pay for past transactions and events. A Net Debt-to-total revenue percentage that is increasing indicates that the Province will need more time to eliminate the Net Debt. The Province's percentage has been increasing over the past five years, most significantly in 2010. The improvements made from 2004-2007 have now been lost as the 2012 amount exceeds that of 2004. We have assessed this trend as unfavourable.

Expense by Function-to-Total Expenses

2.31 Table 2.15 presents expense by function-to-total expenses.

Table 2.15 - Comparison of Expense by Function-to-Total Expenses

Comparison of Expense by Function-to-Total Expenses										
	2012		2011		2010		2009		2008	
	($ millions)	(%)	($ millions)	(%)	($ millions)	(%)	($ millions)	(%)	($ millions)	(%)
Labour and Employment	108.8	1.3	141.7	1.7	141.5	1.7	124.4	1.6	119.1	1.7
Resources	209.5	2.6	215.1	2.6	205.8	2.6	204.2	2.8	203.3	2.9
Protection Services	225.2	2.8	250.6	3.1	209.5	2.7	223.8	3.0	187.5	2.7
Economic Development	246.1	3.1	328.4	4.0	343.7	4.4	286.3	3.9	226.8	3.3
Transportation	395.6	4.9	402.7	4.9	381.4	4.9	380.7	5.2	364.0	5.2
Central Government	690.0	8.6	750.2	9.2	692.0	8.9	686.1	9.3	623.7	9.0
Service of the Public Debt	661.8	8.2	641.5	7.8	616.6	7.9	602.5	8.2	576.9	8.3
Social Development	1,031.8	12.8	1,037.5	12.7	997.1	12.8	961.0	13.0	930.5	13.4
Education and Training	1,747.4	21.7	1,723.7	21.1	1,632.0	20.9	1,457.0	19.8	1,433.3	20.7
Health	2,733.4	34.0	2,687.0	32.9	2,595.6	33.2	2,448.7	33.2	2,275.3	32.8
Total	**8,049.6**	**100.0**	**8,178.4**	**100.0**	**7,815.2**	**100.0**	**7,374.8**	**100.0**	**6,940.4**	**100.0**

2.32 The years ended 31 March 2009 to 31 March 2012 reported deficits. This means that while individual expense trends may have remained steady, this was achieved by incurring a total level of expenses that was in excess of revenue generated in those years. Education and Training and Health's allocation of expenses consume over 50% of the total expenses, consistent with prior years.

2.33 The most significant trend in Table 2.15 is that in 2012, there was no overall year-over-year growth in expenses, in fact, there was a decrease from $8.18 billion to $8.05 billion.

2.34 Another significant trend in Table 2.15 is that the growth in expenses pertaining to the Service of the Public Debt out-paced the allocation of expenditures for certain other expense function areas including Transportation and Social Development. The impact of New Brunswick's growing Net Debt will need to be closely monitored in the future as it consumes resources that would otherwise be used to deliver services. We have assessed this indicator as neutral.

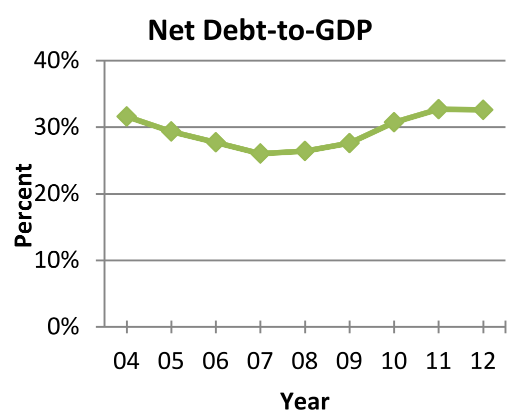
Net Debt-to-GDP

2.35 The sustainability indicator, Net Debt-to-GDP is presented in the Table 2.16. The Province also reports this indicator in Volume 1 of the Public Accounts.

Table 2.16 - Comparison of Net Debt-to-GDP

Comparison of Net Debt-to-GDP

Year ended	Net Debt ($ millions)	GDP ($ millions)	Net Debt/ GDP (percent)
2004	7,067.2	22,366	31.6%
2005	6,948.2	23,672	29.4%
2006	6,853.6	24,716	27.7%
2007	6,739.6	25,847	26.1%
2008	7,132.2	27,044	26.4%
2009	7,590.2	27,499	27.6%
2010	8,582.7	27,920	30.7%
2011	9,615.7	29,448	32.7%
2012	10,045.8	30,773	32.6%



2.36 This indicator compares the Province's Net Debt, the difference between its liabilities and its financial assets, to its GDP. This ratio declined from 2004 to 2007 indicating that over that time period the level of the Province's debt became less onerous on the economy. The ratio increased from 2008 to 2011 because the rate of growth of Net Debt exceeded the rate of growth in GDP over that time period. In 2012, the change in the ratio was minimal, and remains near its highest point since 2004. This means the Net Debt of the Province is increasing faster than the growth in the economy thus becoming more of a burden on the economy. We have assessed the trend as unfavourable.

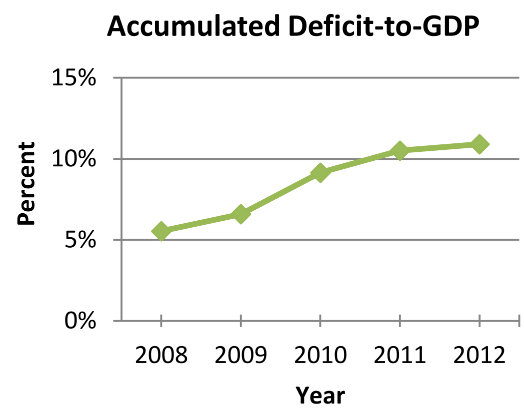
Accumulated Deficit-to-GDP

2.37 In the Table 2.17, we present the sustainability indicator accumulated deficit-to-GDP.

Table 2.17 - Comparison of Accumulated Deficit-to-GDP

Comparison of Accumulated Deficit-to-GDP

Year ended	Accumulated deficit ($ millions)	GDP ($ millions)	Accumulated deficit/GDP (percent)
2008	1,492.7	27,044	5.5%
2009	1,811.1	27,499	6.6%
2010	2,551.0	27,920	9.1%
2011	3,097.5	29,448	10.5%
2012	3,368.0	30,773	10.9%



2.38 The accumulated deficit is the extent to which annual revenues have been insufficient to cover the annual costs of providing services. The information above shows that from 2008 to 2012, the accumulated deficit has increased faster than the growth of the economy. This represents an unfavourable trend as spending rates increased faster than the economy was expanding.

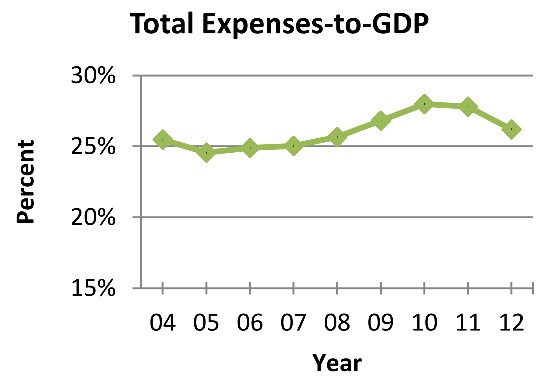
Total Expenses-to-GDP

2.39 Table 2.18 presents the total expenses-to-GDP indicator.

Table 2.18 - Comparison of Total Expenses-to-GDP

Comparison of Total Expenses-to-GDP

Year ended	Total expenses ($ millions)	GDP ($ millions)	Total expenses/GDP (percent)
2004	5,700.0	22,366	25.5%
2005	5,814.3	23,672	24.6%
2006	6,151.7	24,716	24.9%
2007	6,471.8	25,847	25.0%
2008	6,940.4	27,044	25.7%
2009	7,374.8	27,499	26.8%
2010	7,815.2	27,920	28.0%
2011	8,178.4	29,448	27.8%
2012	8,049.6	30,773	26.2%



2.40 This indicates that for five years government expenses were held to about 25% of GDP, however, from 2008 to 2011 the percentage was higher. This represents an unfavourable long-term trend as expenses are growing faster than the economy is expanding. The ratio has decreased in 2012 and we assess the short-term trend as favourable.

Table 2.19 - Trends for Sustainability Indicators

Sustainability Indicator Trends

Sustainability indicator	Short-term trend	Long-term trend
Assets-to-liabilities	Neutral	Unfavourable
Financial assets-to-liabilities	Neutral	Unfavourable
Net Debt-to-total annual revenue	Unfavourable	Unfavourable
Expense by function-to-total expenses	Neutral	Neutral
Net Debt-to-GDP	Unfavourable	Unfavourable
Accumulated deficit-to-GDP	Unfavourable	Unfavourable
Total expenses-to-GDP	**Favourable**	Unfavourable

Summary of Sustainability Indicators

2.41 In summary, while some sustainability indicators have changed slightly in the short term, our overall assessment of the long-term trends in sustainability indicators remains unfavourable. This long-term negative trend should be of concern to New Brunswickers.

Flexibility Indicators

2.42 Flexibility is the degree to which the government can change its debt or tax burden on the economy to maintain programs and meet existing creditor requirements.

Public Debt Charges-to-Revenues

2.43 One of the most publicized factors which affects the flexibility of governments is the cost of servicing the public debt. This is considered to be an indicator of flexibility, since the Province's first payment commitment is to service its debt, leaving no flexibility in the timing of these payments.

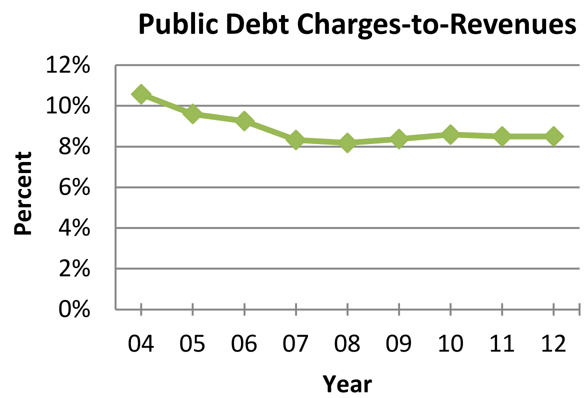
2.44 The cost of servicing the public debt is comprised mainly of interest on the funded debt of the Province. It also includes foreign exchange paid on interest and maturities during the year, the amortization of foreign exchange gains and losses, and the amortization of discounts and premiums which were incurred on the issuance of provincial debt. It does not include principal repayments on the funded debt of the Province.

2.45 In Table 2.20, we present the public debt charges-to-revenues. The Province also reports this indicator in Volume 1 of Public Accounts.

Table 2.20 - Comparison of the Public Debt Charges-to-Revenues

Comparison of the Public Debt Charges-to-Revenues

Year ended	Cost of servicing public debt ($ millions)	Revenue ($ millions)	Cost of servicing public debt/ revenue (percent)
2004	581.8	5,503.3	10.6%
2005	579.6	6,034.8	9.6%
2006	590.3	6,378.0	9.3%
2007	558.0	6,703.5	8.3%
2008	575.7	7,037.8	8.2%
2009	601.4	7,184.0	8.4%
2010	607.2	7,070.4	8.6%
2011	641.5	7,521.4	8.5%
2012	661.8	7,789.0	8.5%



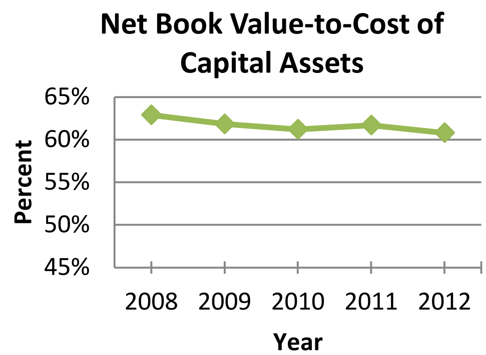
2.46 This table shows that the cost of servicing the public debt as a percentage of the Province's total revenues is significantly lower in the year ended 31 March 2012 than it was in the year ended 31 March 2004. This means that the Province is spending proportionately less of its current year revenue to cover debt charges resulting in more current year revenue available to cover services to the public. For the past two years, the ratio has remained the same and we are assessing the short-term trend as neutral. We are assessing the long-term trend as favourable as the current year's ratio is less than the ratio in 2004. Although we are assessing this indicator as favourable, caution is needed when looking at this indicator. The cost of servicing the Province's debt is increasing in a time when interest rates have declined and the Province's debt is increasing significantly.

Net Book Value of Capital Assets-to-Cost of Capital Assets

2.47 We present the net book value of capital assets-to-cost of capital assets in the Table 2.21.

Table 2.21 - Comparison of Net Book Value of Capital Assets-to-Cost of Capital Assets

Comparison of Net Book Value of Capital Assets-to-Cost of Capital Assets			
Year ended	**Net book value ($ millions)**	**Capital cost ($ millions)**	**Net book value/ capital cost (percent)**
2008	6,261.9	9,947.8	62.9%
2009	6,429.5	10,387.7	61.9%
2010	6,706.0	10,959.3	61.2%
2011	7,241.7	11,733.2	61.7%
2012	7,395.9	12,160.0	60.8%



2.48 This data indicates that the Province's inventory of capital assets as at 31 March 2012 has 60.8% of its average useful life remaining. This roughly means that on average any Provincial assets that were originally expected to be useable for ten years still had just over six years of remaining useful life at 31 March 2012, and assets with original useful lives of twenty years were still considered useable for just over twelve years on average. As the ratios have remained relatively the same over the past five years, we are assessing the short-term and long-term trends as neutral.

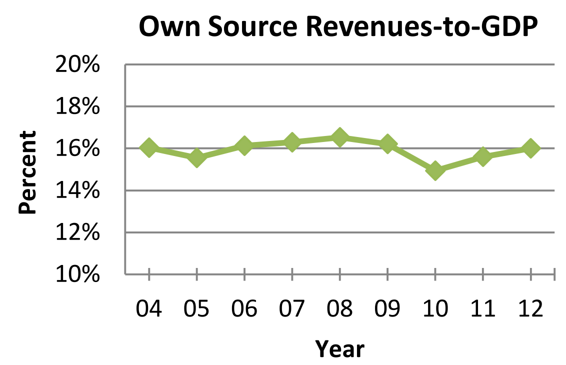
Own Source Revenues-to-GDP

2.49 We present own source revenues-to-GDP in Table 2.22. The Province also reports this indicator in Volume 1 of Public Accounts.

Table 2.22 - Comparison of Own Source Revenues-to-GDP

Comparison of Own Source Revenues-to-GDP

Year ended	Own source revenues ($ millions)	GDP ($ millions)	Own source revenues/ GDP (percent)
2004	3,585.4	22,366	16.0%
2005	3,680.0	23,672	15.5%
2006	3,985.1	24,716	16.1%
2007	4,216.1	25,847	16.3%
2008	4,460.1	27,044	16.5%
2009	4,457.8	27,499	16.2%
2010	4,169.4	27,920	14.9%
2011	4,602.1	29,448	15.6%
2012	4,915.2	30,773	16.0%



2.50 The own source revenues-to-GDP indicator measures the extent to which the Province is raising its revenue through extracting it from the provincial economy. If the ratio increases, more of the Province's revenue is generated from the provincial economy. For example, an increase in this ratio could result if the Province increased taxes. If the ratio decreases, less of the Province's revenue is generated from the provincial economy. A decreasing ratio increases the Province's ability to raise taxes, thus, making the Province more flexible in how it can generate revenue.

2.51 Generally, this ratio has stayed the same over the long-term. There was a decrease in the year 2010 mostly as a result of a large loss by the New Brunswick Electric Finance Corporation (EFC). In that year, the reduction in own source revenue was not as a result of lower fees or taxes.

2.52 In 2012, own source revenue increased by $313.1 million. The most significant sources of this increase were EFC having a surplus of $145.0 million, resulting in an increase in investment income of approximately $141.4 million. Taxes also increased by $144.4 million, the majority of which results from an increase in HST revenue of $72.8 million. We have assessed both the long-term and short-term trend as neutral.

2.53 A note of caution should be taken when looking at this indicator for the last four years. The Province incurred deficits which means it did not generate enough revenue in any of those years to cover expenses.

Summary of Flexibility Indicators

2.54 This year, we have reported on three flexibility indicators.

Table 2.23 - Trends for Flexibility Indicators

Trends for Flexibility Indicators		
Flexibility indicator	**Short-term trend**	**Long-term trend**
Public debt charges-to-revenues	Neutral	Favourable
Net book value of capital assets-to-cost of capital assets	Neutral	Neutral
Own source revenues-to-GDP	Neutral	Neutral

2.55 The cost of servicing the public debt as a percentage of revenues indictor is stable in the short term and is lower than it was in the year ended 31 March 2004, resulting in a favourable long-term assessment, however, caution is needed in interpreting this result as the cost of servicing the Province's debt is increasing in a time when rates are decreasing and the Province's debt load is increasing.

2.56 Own source revenue as a percentage of GDP was higher in the year ended 31 March 2012 because of a higher annual surplus for the New Brunswick Electric Finance Corporation (EFC) and an increase in taxation revenue in 2012. However, the Province incurred a deficit of $260 million in the 2011-12 fiscal year. Therefore, we have judged the long-term trend to be neutral.

Vulnerability Indicators

2.57 Vulnerability is the degree to which a government is dependent on sources of funding outside its control or influence.

Government Transfers-to-Total Revenues

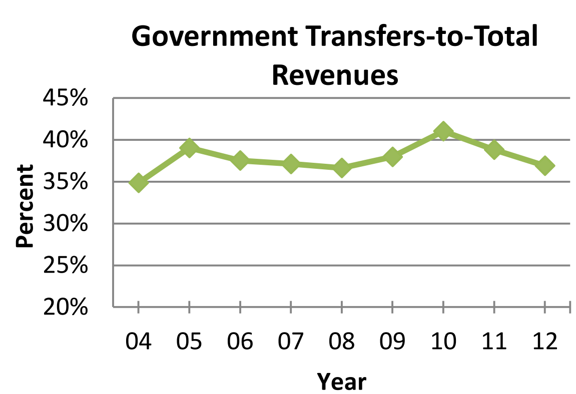
2.58 By comparing the proportion of total revenue that comes from the federal government to the total revenue of the Province, we get a measure of the degree to which the Province is dependent on the federal government. If that dependence increases, the Province is more vulnerable to funding decisions made by the federal government. This indicator highlights the degree to which one indicator can be impacted by another indicator. For example, if the Province were in a position to reduce its dependence on the federal government by generating more own source revenue, the Province's vulnerability position might improve, but its sustainability position might become worse.

2.59 Table 2.24 presents the comparison of government transfers-to-total revenues. The Province also reports this indicator in Volume 1 of Public Accounts.

Table 2.24 - Comparison of Government Transfers-to-Total Revenues

Comparison of Government Transfers-to-Total Revenues

Year ended	Federal government transfer revenue ($ millions)	Total revenue ($ millions)	Federal government transfer revenue/ total revenue (percent)
2004	1,917.9	5,503.3	34.8%
2005	2,354.8	6,034.8	39.0%
2006	2,392.9	6,378.0	37.5%
2007	2,487.4	6,703.5	37.1%
2008	2,577.6	7,037.8	36.6%
2009	2,726.5	7,184.0	38.0%
2010	2,901.0	7,070.4	41.0%
2011	2,919.3	7,521.4	38.8%
2012	2,873.8	7,789.0	36.9%



2.60 Table 2.24 shows that the Province's reliance on government transfers has been steadily decreasing since 2010. For the 2012 year, revenues increased because of the surplus of $145.0 million in EFC, compared to $10.8 million in the prior year, as well as an increase of $72.8 million of the provincial portion of HST revenue. Thus we are assessing the short-term trend as favourable and the long-term trend as mixed.

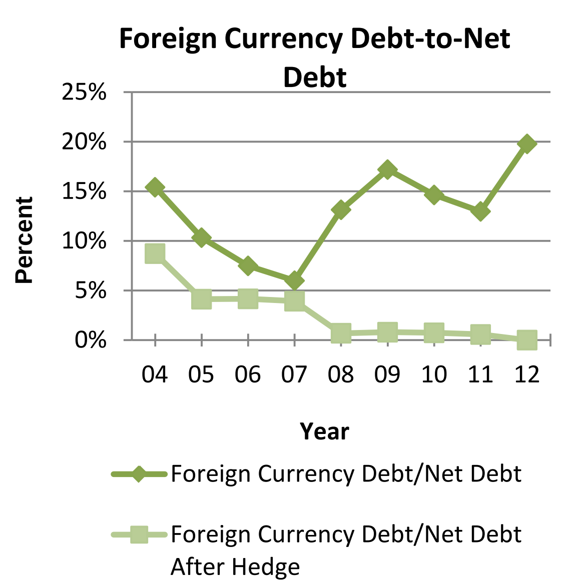
Foreign Currency Debt-to-Net Debt

2.61 The foreign currency debt-to-Net Debt indicator measures the Province's potential vulnerability to currency fluctuations and is presented in Table 2.25.

Table 2.25 - Comparison of Foreign Currency Debt-to-Net Debt

Comparison of Foreign Currency Debt-to-Net Debt

Year ended	Foreign currency debt ($ millions)	Net Debt ($ millions)	Foreign currency debt/ Net Debt (percent)	Foreign currency debt/ Net Debt after hedge (percent)
2004	1,088.9	7,067.2	15.4%	8.7%
2005	717.5	6,948.2	10.3%	4.1%
2006	512.9	6,853.6	7.5%	4.2%
2007	403.5	6,739.6	6.0%	3.9%
2008	937.0	7,132.2	13.1%	0.7%
2009	1,304.8	7,590.2	17.2%	0.8%
2010	1,255.8	8,582.7	14.6%	0.7%
2011	1,247.3	9,615.7	13.0%	0.6%
2012	1,986.8	10,045.8	19.8%	0.0%



2.62 The above information shows that the Province's foreign currency debt has increased over the years. The risk of exposure to foreign currency fluctuations, however, is offset by the Province's hedging strategy. The Province uses several alternatives to reduce (hedge) risk associated with debt repayable in foreign currencies:

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

2.63 From Table 2.25, we see the risk of exposure to foreign currency fluctuations has decreased significantly over time. Because of the effectiveness of the Province's hedging strategy, we assess this indicator as favourable.

Summary of Vulnerability Indicators

2.64 We have assessed the short-term and the long-term trend for both indicators:

Table 2.26 - Trends for Vulnerability Indicators

Trends for Vulnerability Indicators		
Vulnerability indicator	**Short-term trend**	**Long-term trend**
Government transfers-to-total revenues	Favourable	Mixed
Foreign currency debt-to-Net Debt	Favourable	Favourable

2.65 In summary, the Province's vulnerability exposure is mixed. In years when EFC generates income through its investment in NB Power, the Province's reliance on federal revenue decreased and this indicator improves. In general, the Province is doing a good job at limiting its exposure to fluctuations in foreign currency.

Comments on Components of the Province's Financial Statements

2.66 In this section, we discuss significant trends we have observed in the Province's financial statements. We have highlighted these trends to raise public awareness and to provide legislators with an independent assessment of the areas we believe should be a focus for the government.

Deficit

2.67 For the year ended 31 March 2012, the Province reported a deficit of $260.6 million. This is a decrease of $396.4 million from the $657.0 million deficit reported for the year ended 31 March 2011.

2.68 Table 2.27 shows, at a high level, the reasons for the change in the deficit from 31 March 2011 to 31 March 2012.

Table 2.27 - Analysis of Deficit Decrease

Analysis of Deficit Decrease	
	(millions)
2011 Deficit	$657.0
Increase in provincial source revenue	(313.1)
Decrease in federal source revenue	45.5
Decrease in expense	(128.8)
2012 Deficit	**$260.6**

2.69 Increases in provincial source revenue are mainly attributable to increases in tax revenues primarily in the provincial portion of Harmonized Sales Tax of $72.8 million and an increase in earnings of New Brunswick Electric Finance Corporation (EFC) of $134.2 million.

2.70 The overall decrease in federal source revenue of $45.5 million is attributable to changes in three federal revenue sources. There was a reduction of $29.2 million in fiscal equalization payments, due to a narrowing of fiscal disparities between New Brunswick and the national average. There was also a reduction of $48.5 million in conditional grant revenue primarily due to the expiry of various federal training and stimulus funding agreements and disaster assistance funding in 2011. These revenue reductions were offset by an increase of $32.2 million in the amount of unconditional grant revenue, which was mainly due to the Canada Health Transfer and the Canada Social Transfer.

2.71 Total expenditures have decreased by $128.8 million. This is attributable to a reduction in expenditures by most departments, the most significant being a reduction of $82.3 million by Economic Development and $60.2 million by Central Government. The overall decrease in expenditures was offset by an increase in expenditures for Health of $46.4 million, Education and Training of $23.7 million and Service of the Public Debt of $20.3 million.

Expenses

2.72 Table 2.28 shows the one year growth rate and the average growth rate for the past three years.

Table 2.28 - Expense Trends by Function

Expense Trends by Function (percent)				
Average annual growth rate	**Function**	**2012 growth rate**	**2011 growth rate**	**2010 growth rate**
6.3	Education and training	1.4	5.6	12.0
3.7	Health	1.7	3.5	6.0
3.2	Service of the public debt	3.2	4.0	2.3
2.4	Social development	(0.6)	4.1	3.7
1.3	Transportation	(1.8)	5.6	0.2
1.0	Protection services	(10.1)	19.6	(6.4)
0.9	Resources	(2.6)	4.5	0.8
0.4	Central government	(8.0)	8.4	0.9
(3.1)	Labour and employment	(23.2)	0.1	13.7
(3.2)	Economic development	(25.1)	(4.5)	20.0
3.0	**Total**	**(1.6)**	**4.6**	**6.0**

2.73 Table 2.28 shows the Province's rate of spending and expenses slowed considerably especially in 2012. In fiscal 2012, all functions showed a decrease in growth rate with seven of ten function areas showing negative growth which implies cost reductions were realized. The annualized three year expense growth rate for 2012 was 3%. This is an improved result over the rate for the prior year which was 5.6%.

2.74 We noted the expense growth rate has slowed in Health and Education and training, the largest expense function areas. Health's 1.7% growth rate in 2012 is particularly noteworthy because in prior years Health's expense growth rate was 6% in 2010 and 3.5% in 2011.

2.75 However, Table 2.28 shows Service of the Public Debt experienced the largest growth rate in 2012 amongst all expense functions. Service of the Public Debt represents interest costs on the Province's debt.

In comparing the three year average growth rate, Service of the Public Debt experienced the third largest growth behind Education and training and Health. These growth rates are concerning as they illustrate the inflexibility of this particular expense in a period where, as Table 2.28 shows, government was reducing or restraining spending in other expense functions. It also illustrates that regardless of the current restraint efforts of government, past deficit financing continues to have a fiscal impact. Interest costs may grow if debt continues to increase or, upon refinancing, interest rates rise.

Receivables, Advances, Loans and Allowances

2.76 There are significant amounts of money owed to the Province by taxpayers, businesses, and the federal government. As shown in Table 2.29 at 31 March 2012, over $1.4 billion was owed to the Province, gross of allowances that had been set up for receivables, advances, and loans. There was an additional $1.1 billion in taxes receivable.

Table 2.29 - Amounts Owed to the Province

Amounts Owed to the Province ($ millions)										
	2012	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**
Accounts receivable and advances	606.8	690.0	733.0	622.7	607.7	522.8	590.5	543.0	476.3	439.3
Loans	870.2	858.5	822.4	736.8	626.0	560.6	512.9	262.7	255.6	292.3
Total A/R, advances, loans	**1,477.0**	**1,548.5**	**1,555.4**	**1,359.5**	**1,233.7**	**1,083.4**	**1,103.4**	**805.7**	**731.9**	**731.6**
Total taxes receivable	**1,126.3**	**1,144.6**	**1,112.0**	**1,122.9**	**954.2**	**1,046.6**	**554.9**	**488.9**	**553.2**	**507.0**

2.77 We continue to believe the management of the amounts owed to the Province is critical to reducing interest costs. Assuming an interest rate of 5%, we calculate interest cost associated with the balances of receivables, advances and loans to be approximately $74.0 million annually.

Receivables and Advances

2.78 Table 2.30 shows the total amount of accounts receivable and advances decreased from the previous year. At 31 March 2012 the total was $606.8 million, a decrease of 12.1%. We note there have been decreases in both the amounts owed to the Province and the related allowances. This was mostly due to the authorization by the Board of Management to delete the assets of the Province that were no longer considered collectible.

2.79 Table 2.30 provides details of the Province's receivables and advances:

Table 2.30 - Allowances for Receivables and Advances

Allowances for Receivables and Advances ($ millions)									
	2012	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**
Total accounts receivable and advances before allowance for doubtful accounts	606.8	690.0	733.0	622.7	607.7	522.8	526.4	543.0	476.3
Less receivables from the federal government	(160.7)	(216.7)	(204.5)	(182.0)	(205.0)	(169.7)	(164.0)	(141.6)	(132.3)
Less advances of grants	(26.6)	(10.7)	(37.6)	(13.0)	(12.7)	(21.9)	(51.5)	(55.2)	-
Subtotal	419.5	462.6	490.9	427.7	390.0	331.2	375.0	346.2	344.0
Allowance for doubtful accounts	**(231.8)**	**(250.2)**	**(306.0)**	**(244.0)**	**(201.3)**	**(155.7)**	**(140.7)**	**(132.9)**	**(118.5)**
Allowance percentage	**55.3%**	**54.0%**	**62.3%**	**57.0%**	**51.6%**	**47.0%**	**37.5%**	**38.4%**	**34.4%**

Federal Government Receivables

2.80 The amount receivable from the Federal government decreased by $56.0 million during the year ended 31 March 2012, a decrease of 25.8%. Details of the amounts due from the federal government are found in Table 2.31.

Table 2.31 - Receivables from the Federal Government

Receivables from the Federal Government ($ millions)							
	2012	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**
Central Government Services	71.7	76.4	50.4	69.1	45.2	46.4	39.9
Economic Development	33.9	69.8	45.1	32.8	21.9	26.1	19.8
Education	22.1	24.6	28.7	49.5	63.8	47.2	49.9
HST Rebate	17.7	22.7	24.4	12.6	14.2	16.1	17.3
Transportation	3.8	13.5	46.0	6.6	16.6	22.8	25.7
Health	0.1	0.5	0.7	1.3	31.5	1.2	4.5
Other	11.4	9.2	9.2	10.1	11.8	9.9	6.9
Total	**160.7**	**216.7**	**204.5**	**182.0**	**205.0**	**169.7**	**164.0**

2.81 The largest component of the receivable from the Federal government is Central Government Services. Of the $71.7 million receivable, $41 million relates to Disaster Financial Assistance relating to floods in 2008 and 2010. The amount has not been collected from the Federal government yet because the necessary claims have not been filed.

2.82 The amount owing for Economic Development decreased from $69.8 million to $33.9 million at 31 March 2012. This receivable relates to federal-provincial cost shared agreements.

Loans

2.83 Table 2.32 provides details of the Province's loans receivable.

Table 2.32 - Loans Receivable

Loans Receivable ($ millions)										
	2012	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**
Loans to students	431.6	415.1	391.0	369.2	336.4	296.0	258.3	0.2	0.2	0.2
Economic Development Act	305.7	314.3	303.6	246.3	169.8	146.0	135.5	135.8	124.1	155.7
New Brunswick Housing Act	33.4	33.8	35.9	35.5	34.0	34.8	34.5	33.6	32.7	31.8
Energy efficiency upgrade loans	13.7	14.3	11.1	7.3	3.6	2.3	0.2	-	-	-
Fisheries Development Act	37.6	29.4	35.2	36.4	40.1	39.2	40.1	42.6	48.8	54.4
Agricultural Development Act	12.5	9.8	11.2	5.4	4.4	4.2	18.1	21.3	21.7	20.3
Beaverbrook Art Gallery	2.0	7.6	6.6	6.6	4.5	4.5	1.0	1.0	-	-
Loans to municipalities	-	1.6	3.4	5.4	7.3	9.2	1.0	1.6	1.6	1.9
Fundy Trail Endowment Fund	3.6	3.5	3.3	3.1	2.9	2.8	2.6	4.0	3.8	3.6
Unsatisfied judgements	9.4	9.4	9.5	9.5	9.5	9.5	9.5	9.5	9.5	9.5
L'Office de Stabilisation	4.0	4.0	4.1	4.1	4.0	-	-	-	-	-
La Fondation du quotidien francophone	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Provincial Holdings Ltd.	7.5	7.6	2.6	2.9	4.1	6.2	6.0	6.5	6.7	8.1
Other loans	5.2	4.1	0.9	1.1	1.4	1.9	2.1	2.6	2.5	2.8
Subtotal	**870.2**	**858.5**	**822.4**	**736.8**	**626.0**	**560.6**	**512.9**	**262.7**	**255.6**	**292.3**
Allowance for doubtful loans receivable	(276.8)	(269.1)	(313.3)	(297.9)	(229.3)	(207.2)	(192.9)	(142.6)	(129.3)	(143.9)
Total	**593.4**	**589.4**	**509.1**	**438.9**	**396.7**	**353.4**	**320.0**	**120.1**	**126.3**	**148.4**
(percent)										
Percentage of doubtful loans receivable	31.8	31.3	38.0	40.4	36.6	37.0	37.6	54.1	50.6	49.2

2.84 Table 2.32 presents the long term increase in loan balances. Since 31 March 2006, the year the

Province added student loans to its loan portfolio, total loans have increased over 85%, an average increase of over 14% per year.

Allowances

2.85 Table 2.33 accumulates all allowances for losses to provide a comprehensive picture.

Table 2.33 - Allowances

Allowances ($ millions)										
	2012	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**
Allowance for losses	163.9	165.3	95.5	101.8	103.1	95.8	84.0	67.1	75.8	50.2
Allowance for doubtful loans receivable	276.8	269.1	313.3	297.9	229.3	207.2	192.9	142.6	129.3	143.9
Allowance for doubtful taxes receivable	37.0	43.8	61.8	56.5	55.1	77.0	85.4	96.9	86.6	89.5
Allowance for doubtful receivables and advances	231.8	250.2	306.0	244.0	201.3	155.7	140.7	132.9	118.5	113.3
Total	**709.5**	**728.4**	**776.6**	**700.2**	**588.8**	**535.7**	**503.0**	**439.5**	**410.2**	**396.9**

2.86 The total of all of the Province's allowances continues to be concerning. The balance decreased slightly at 31 March 2012, after the Board of Management's authorization to write-off uncollectible accounts of $52.7 million.

2.87 The following table analyzes the total allowance for the past five years.

Table 2.34 - Allowance Summary

Allowance Summary ($ millions)					
	2012	**2011**	**2010**	**2009**	**2008**
Opening balance	728.4	776.6	700.2	588.7	535.7
New allowance	33.8	109.6	103.8	108.3	59.0
Write offs	(52.7)	(155.1)	(16.3)	(7.5)	(5.6)
Adjustment		2.7	(11.1)	10.7	(0.4)
Closing balance	**709.5**	**728.4**	**776.6**	**700.2**	**588.7**

2.88 We are pleased collectability of provincial receivables is being reviewed with required allowances and write offs assessed. We hope this process continues annually. Active management and collection of receivables is an important part of good fiscal management. However, it is troubling for two consecutive years there have been write offs for unrecoverable amounts totalling over $200 million. We understand this amount is generated from several years of not writing off old amounts previously allowed for. Overall, it is concerning that this magnitude of write off is required, especially when the Province is experiencing financial difficulty.

Asset Acquisition and Management-Chancery Place

2.89 In March of 2011, the Province purchased the Chancery Place building on King Street, Fredericton for $39 million. As part of our 31 March 2011 audit, the acquisition was examined from an accounting perspective. However, the building remains unoccupied.

2.90 During the 2012 year, the Province made further expenditures of approximately $4.8 million. We understand the delay was due to uncertainty around departmental reorganization and the decision to retender a portion of interior fit up work. Both factors affected the planned occupancy date.

2.91 The costs the Province is incurring on a vacant building raises economy and efficiency concerns. We understand the planned occupancy date is now May 2013.

Sick Leave Obligation

2.92 Under Canadian public section accounting standards, a government should recognize a liability and an expense for certain employee benefits, such as sick leave. Historically, the Province had assessed the impact of sick leave on the financial statements as not significant and therefore the Province had not recorded a liability regarding sick leave obligations in its financial statements. In response to our 2011 recommendation, the Province undertook the process of determining the magnitude of the sick leave obligation. The estimate of a liability for employee benefits such as sick leave can be a complex process. For this reason the Province engaged professional actuaries to assist with the calculations. The results showed the sick leave obligation figure was significant.

Table 2.35 - Sick Leave Obligation

Sick Leave Obligation ($ millions)				
	2012	**2011**	**2010**	**2009**
Government Departments	50.2	48.8	42.7	36.6
School Districts	59.4	58.6	51.3	44.0
Other agencies	97.0	94.1	90.7	87.0
Total	**206.6**	**201.6**	**184.7**	**167.6**

2.93 As can be seen in Table 2.35, the amount recorded as a liability in the Province's 31 March 2012 financial statements was $206.6 million. This change was recorded retroactively as disclosed in Note 19 to the Province's financial statements. Regional Health Authorities, which are consolidated with the Province, recognized their sick leave liability for the first time in 2011. This resulted in a total of $86.8 million being included in the financial statements last year.

2.94 It is important to note this estimated value is based on a number of factors and assumptions. The valuation of the liability could change significantly in response to changes in assumptions or a change in policies.

2.95 In the 2012-13 budget, the Province announced its intent to review its sick leave policies and possibly make changes. Depending on the nature of the changes contemplated, due to the sensitivity of the estimates used, these changes may impact significantly the liability recorded in the financial statements.

2.96 Due to the magnitude of the liability, departments need to continue to prudently manage this obligation, monitor/manage absenteeism and prevent abuse of policies. In addition, departments need to ensure appropriate supporting documentation is maintained for approved absences.

Upcoming Changes to Public Sector Accounting Standards

2.97 Accounting standards are constantly evolving. Governments are subject to Public Sector Accounting Standards (PSAS) which is governed by the Public Sector Accounting Board of Canada. While no new standards were required to be adopted for the 2012 fiscal year, Table 2.36 shows when the new standards are required to be adopted by the Province of New Brunswick.

Table 2.36 - *Public Sector Accounting Standards Changes*

Section	Fiscal year end requiring adoption
PS 3410: Government Transfers, Revised	31 March 2013
PS 3510: Tax Revenue	31 March 2013
PS 3260: Liability for Contaminated Sites	31 March 2015
PS 1201: Financial Statement Presentation	31 March 2016
PS: 2601: Foreign Currency Translation	31 March 2016
PS 3450: Financial Instruments	31 March 2016

2.98 For fiscal 2012-13, significant accounting standards changes for the Province are expected to be limited to PS 3410 Government Transfers. This standard provides new guidance on when it is appropriate to recognize revenue resulting from government transfers. The standard outlines the recognition criteria for both the transferring government and the recipient government.

2.99 The Province anticipated some of the Government Transfer standard change in its 2012-13 Main Estimates. While we have not yet audited this fiscal year, we note the budget was prepared on a different basis than prior years pertaining to government transfers.

2.100 The most notable impact of the new standard is the upfront recognition of federal funding received for highway projects. Revenue of $232 million is budgeted to be recognized in 2012-13. In prior years, this amount would have been deferred and amortized into revenue over a number of years.

2.101 This accounting change adopted for budgeting purposes had a significant impact on the planned 2012-13 fiscal result. Without the effect of adopting this new accounting standard in the budget, using estimates from prior years, the deficit would then have been increased by approximately $185 million.

2.102 In addition to the treatment of transfers as revenue by the Province, there is the matter of how to account for deferred capital contributions of $974.5 million in accordance with the new standards. Depending on the options chosen upon implementation, adjustments to this balance may cause a significant change in the 2012-13 financial results.

2.103 We will be reviewing and analyzing the impact of the treatment of this accounting standard change in our 2013 Report.

Accounting for NB Power and NB Electric Finance Corporation

2.104 The Province's financial statements include the results of many Crown corporations and agencies. One of the largest and most complex is the NB Power group of companies (NB Power). NB Power is included in the Province's financial statements through the New Brunswick Electric Finance Corporation (NBEFC). This company was established in 2004 under the authority of the *Electricity Act.* The NBEFC holds and manages the debt and debt related assets and liabilities of NB Power.

2.105 Some key principles used in accounting for these companies in the Province's financial statements are noted below:

- NB Power is a viable business which can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government;
- the NBEFC will be able to receive sufficient payments from NB Power to repay the debt taken on by the NBEFC; and
- the operation of an independent rate setting process.

2.106 We have decided to provide an analysis of the operating results of the NBEFC and NB Power due to the complexity and uncertainty of the underlying accounting issues, particularly rate regulatory accounting, and because these entities' financial results have a significant impact on the Province.

2.107 Net earnings of the NBEFC and NB Power for the past five years are provided in Table 2.37.

Table 2.37 - NB Electric Finance Corporation and NB Power Net Earnings (loss)

NB Electric Finance Corporation and NB Power Net Earnings (loss) ($ millions)					
	2012	**2011**	**2010**	**2009**	**2008**
NBEFC	145	11	(212)	35	105
NB Power	173	67	(117)	70	89

2.108 Each year NB Power's earnings or loss is included in the NBEFC year end results. Then the NBEFC earnings, in turn, are included in the Province's financial statements.

2.109 The NBEFC's primary source of revenue and cash generation is from NB Power. Since the NBEFC manages the debt of NB Power it is dependent on payments from NB Power to service its debt.

2.110 To interpret the results of NB Power's operations, it is necessary to understand how rate regulatory accounting impacts their results.

NB Power and Rate Regulatory Accounting

2.111 Rate regulatory accounting allows NB Power to recognize regulatory assets which represent the right to collect future revenues associated with certain costs incurred in current or prior periods. The costs are expected to be recovered from customers in future periods through the rate-setting process.

2.112 As at 31 March 2012, NB Power had regulatory assets of $943 million ($890 million for the refurbishment of the Point Lepreau Generating Station (PLGS) and $53 million related to the lawsuit settlement with Petróleos de Venezuela S.A.). With respect to the PLGS regulatory deferral asset, these costs are already incurred in current and prior periods. In other words, these costs would have been recorded as expenses in the statements of earnings of corresponding years, if NB Power did not apply rate regulatory accounting.

2.113 Our analysis in this section focuses on the regulatory deferral asset associated with the refurbishment of PLGS, since it represents 94% of total regulatory assets of NB Power.

2.114 The regulatory deferral asset associated with the refurbishment of PLGS accumulates:

- the normal period costs (net of any revenues) incurred by NB Power Nuclear Corporation (Nuclearco);
- the costs of replacement power incurred by NB Power Generation Corporation (Genco), during the refurbishment period;
- less costs included in current rates; and
- interest on the regulatory deferral asset.

2.115 These amounts are to be recovered from ratepayers over the refurbished station's operating life estimated to be 27 years.

2.116 Period costs are costs and expenses incurred by Nuclearco during the out of service period, other than those costs and expenses recorded as capital costs of the project.[1] Typical period costs are:[2]

- transmission services;
- operations, maintenance and administration to maintain reliable operating systems, licensing requirements, and ensure safer reliable operation post refurbishment;
- amortization and decommissioning;
- taxes on the buildings and property; and
- interest charges on long term and short term debt (excluding debt for the capital project and the regulatory deferral asset) and debt portfolio management fees.

2.117 The cost of replacement power represents Genco's fuel and purchased power cost it incurred to provide the energy that would have been produced by PLGS

[1] *Electricity Act* Section 143.1(2)
[2] New Brunswick Energy and Utilities Board. Matter 171: PLGS Deferral Account. "Attachment A – Detailed Explanation of Nuclear Non-Capital Costs" pages 14-17

to serve in-province load. Part of this cost is offset by the current existing electricity rates which reflect the cost of purchased power that would normally have been produced by PLGS.

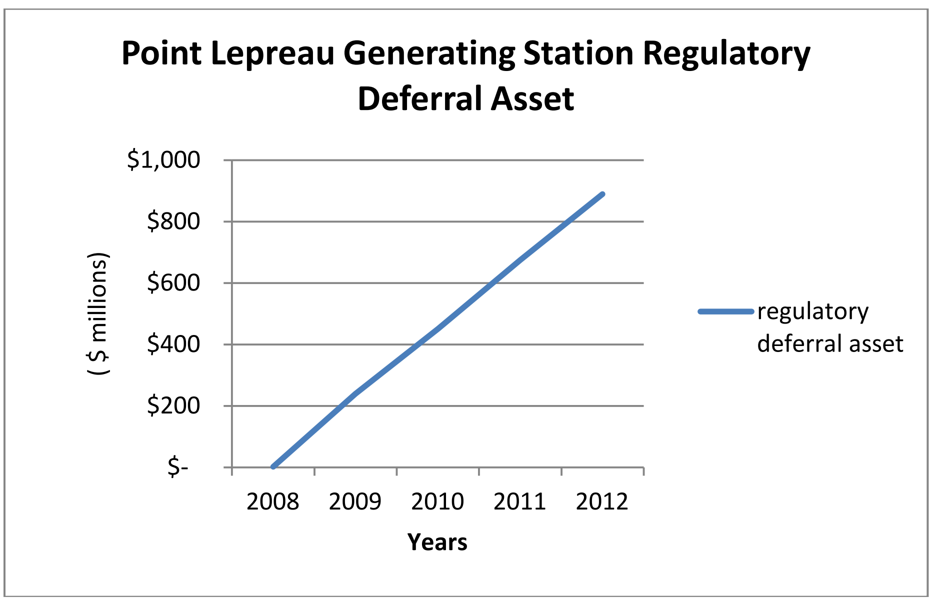
2.118 Tables 2.38 and 2.39 provide the details of the PLGS deferral.

Table 2.38 - Breakdown of PLGS regulatory deferral asset (millions)

Breakdown of PLGS regulatory deferral asset	2008	2009	2010	2011	2012	Total
Costs of replacement power	$ -	$ 267	$ 223	$ 239	$ 200	$ 929
Period costs	2	176	176	164	189	707
Interest on deferral	-	4	16	27	37	84
Offset for costs included in current rates	-	(209)	(206)	(206)	(209)	(830)
Total	$ 2	$ 238	$ 209	$ 224	$ 217	$ 890

2.119 The regulatory deferral asset started to accumulate in 2008. The balance has grown rapidly from $ 2 million in 2008 to $890 million as of 31 March 2012.

Table 2.39 - Point Lepreau Generating Station Regulatory Deferral Asset



NB Power's Recent Earnings or Loss?

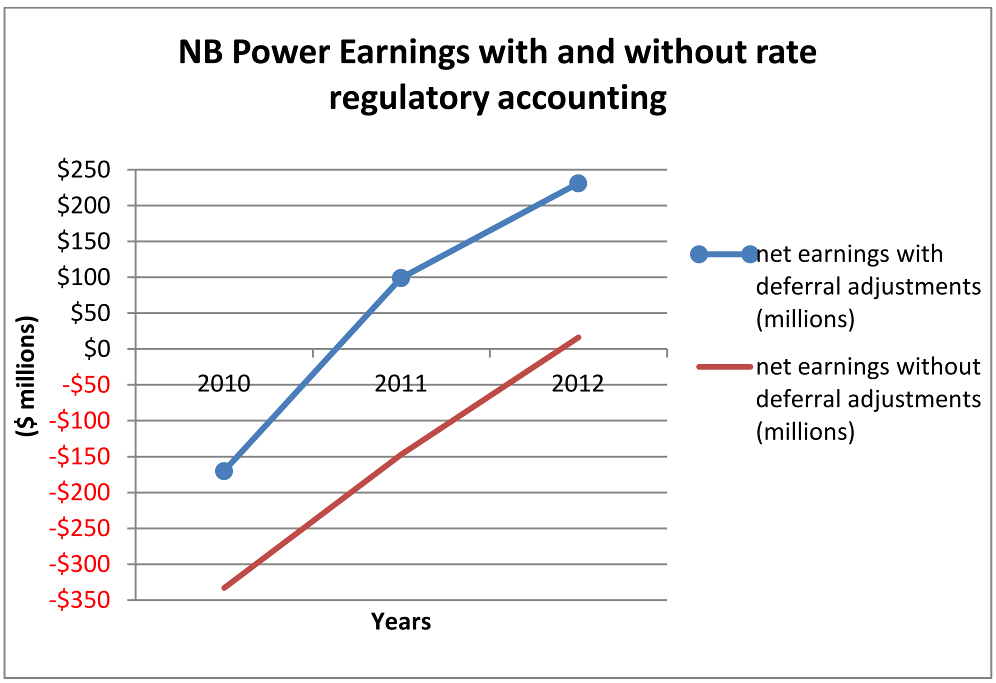
2.120 Tables 2.40 and 2.41 provide information about NB Power's earnings for the past three years. The effects of rate regulatory accounting are factored out to reflect financial performance from operations.

Table 2.40 - NB Power earnings (loss) adjusted to remove the effects of rate regulatory accounting

NB Power earnings (loss) adjusted to remove the effects of rate regulatory accounting (millions)			
	2012	**2011**	**2010**
Net earnings (loss)[1] - rate regulatory accounting	$231	$99	$(170)
Less regulatory deferral adjustment to earnings	(175)	(216)	(147)
Less interest on deferral	(40)	(30)	(16)
Net earnings (loss)[1] adjusted to remove the effects of regulatory deferrals	$16	$(147)	$(333)

[1]*Before special payments in lieu of taxes calculated based on net earnings to the NBEFC in accordance with Regulation 2008-9 of the Electricity Act.*

Table 2.41 - NB Power earnings with and without rate regulatory accounting



Source: NB Power audited financial statements

NB Power's current use of rate regulatory accounting is accepted under Canadian GAAP

2.121 Expenses that would ordinarily be deducted in calculating net earnings have been deferred to future years under rate regulatory accounting. While this practice is currently acceptable under Canadian generally accepted accounting principles (GAAP), it creates the appearance of profitability, however if rate regulatory accounting had not been applied, this would not have been the result, and NB Power would have recorded reduced profitability as shown in Table 2.40. The impact of the deferral adjustments on the reported financial performance of NB Power is significant.

2.122 It should be noted results achieved for 31 March 2012 occurred during a year where NB Power has recorded the highest hydro power generation in the past ten years. NB Power experienced favourable weather conditions including higher than average rainfall, which has decreased power generation costs by approximately $25 million.[3] If favourable weather conditions had not occurred, the 31 March 2012 earnings as per Table 2.40 would have also been presented as a loss.

2.123 In addition to the $890 million regulatory deferral asset, NB Power has invested $1.2 billion as of 31 March 2012 in capital costs toward the refurbishment project. In total, NB Power has invested almost $2.1 billion as of 31 March 2012 on the Point Lepreau refurbishment project which at the time of writing this report has not returned to service.

We reviewed NB Power's model of future financial results

2.124 As part of our audit work, we examined the model which supported NB Power's ability to charge rates in the future at a sufficient level to fully collect the amount of the regulatory asset. At the time of our review, the model's result remained positive when various assumptions were changed within a reasonable range. In the future, the model may or may not produce positive results if there are significant changes in the assumptions.

NB Power's adoption of IFRS may be delayed to 2014/15

2.125 NB Power was expected to convert to International Financial Reporting Standards (IFRS) as required by changes in accounting standards. However, due to a recent decision of the Accounting Standards Board (September 2012) NB Power can elect to defer IFRS implementation until the fiscal year ended 31 March 2015.

2.126 Currently, IFRS does not recognize regulatory

[3] *NB Power Annual Report 2011/12* p. 23

deferred assets or liabilities. Therefore, once adopted NB Power may have to decide how to account for the PLGS regulatory deferral asset in a different manner. To date we have had preliminary discussions with NB Power regarding possible accounting treatments of the regulatory deferral asset.

2.127 Given this impacts a future audit year, we will follow relevant decisions of the Accounting Standards Board and assess NB Power's transition plan to IFRS as events unfold.

Regardless of the accounting, the PLGS refurbishment cost ($2.1 billion as at 31 March 2012) must be recovered through rates

2.128 It is important to note, regardless of the accounting for the PLGS regulatory deferral asset, the fact remains, the PLGS refurbishment cost ($2.1 billion as of 31 March 2012 including $1.2 billion construction cost and $.9 billion deferral) will have to be collected from ratepayers over time.

2.129 In addition, if the Province wishes to continue to account for NB Power as a viable business on the Province's financial statements, NB Power financial results must demonstrate viability. That is, NB Power must maintain its operations and meet its liabilities (including debt repayments) from sources outside of government (ratepayers).

2.130 Currently, NB Power's $4.6 billion debt is not included in the Province's Net Debt. The NB Power amounts reported in the Province's financial statements are limited to net income and net assets included in the NBEFC. If NB Power was to have significant recurring losses and become an investment loss for the Province, it would be an indication NB Power is not viable on its own. At that time, all debts, assets, liabilities, revenue and expenses of NB Power would be included in the Province's statements.

History of government involvement in the NB Power rate setting process

2.131 The Energy and Utilities Board (EUB) is an independent, quasi-judicial board charged with regulating public utilities. The EUB regulates aspects of electricity and natural gas utilities to ensure that customers receive safe and reliable service at reasonable rates. To fulfil its mandates and responsibilities, it is important for EUB to remain independent.

2.132 However with respect to NB Power, successive governments have played a role in the rate setting process by imposing rate increase caps or freezes. Three recent occasions include:

- In 2006, under the authority of the *Electricity Act*,[4] cabinet overturned a decision by the EUB to allow an increase of rates by an average of 9.64%. Government reduced the increase to an average of 6.57 %.
- In 2008, the government issued a policy directive to NB Power *"barring unforeseen circumstances, the maximum average power rate increase for each of the next three years through 2010 will not surpass three per cent."*
- In 2010, the government committed to implement a three-year electricity rate freeze for NB Power ratepayers. NB Power implemented the freeze in September 2010.

2.133 One of the criteria an enterprise that has regulated operations has to meet to be able to use rate regulated accounting is:

> *"The enterprise's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers."*[5]

2.134 Given the above considerations, if such independence factors persist in the future or become significant, the lack of independence may impact NB Power's support for using rate regulatory accounting

[4] Electricity Act *105(1) The Lieutenant-Governor in Council may, within 30 days after the filing of the order or decision of the Board with the Clerk of the Executive Council under section 104, on the Lieutenant-Governor in Council's own motion, modify or reverse an order or decision made by the Board respecting the charges, rates and tolls to be charged by the Distribution Corporation, and such modification or reversal is binding on the Board and on all parties, and the decision of the Lieutenant-Governor in Council.*

[5] *Financial Accounting Standards Board*, Statement of Financial Accounting Standards No.71, paragraph 5 (a). Canadian generally accepted accounting principles do not include an explicit rate regulatory accounting framework and therefore, additional guidance may be consulted such as the United States of America Financial Accounting Standards Board (FASB).

in its financial statements.

2.135 In conclusion, there is much uncertainty regarding NB Power, including:

- PLGS – return to service;
- IFRS – decisions on transition;
- Accuracy of assumptions in the long term projections;
- Independence of the rate setting process; and
- The ability to demonstrate it is a viable business that can maintain operations, repay debt and liabilities from non-government sources, given:
  - Debt of $4.6 billon;
  - Minimal equity;
  - Annual interest burden now in excess of $250 million; and
  - Reduced profitability without the use of rate regulatory accounting.

2.136 We will continue to monitor relevant events and hold discussions with NB Power and government to review these issues.

Provincial Pension Plans

2.137 The Province's pension plans are another significant component of the Province's financial statements. In prior years market fluctuations have exposed the Province to volatility in its financial reporting. The following paragraphs illustrate these trends, as well as discuss other issues associated with the plans.

Pension Expense Growth and Volatility

2.138 Table 2.42 provides details of the Province's total pension expense for the past ten years. For purposes of illustrating the potential volatility of this figure, a longer term approach of ten years has been used in our data analysis.

Table 2.42 - Components of Pension Expense

Components of Pension Expense ($ millions)										
	2012	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**
Employer's share of pension benefits earned	148.9	137.4	131.6	146.1	133.8	126.1	117.0	124.1	96.1	90.6
Net interest expense (revenue)	32.0	52.9	118.2	20.6	(9.1)	0.4	30.9	17.6	85.4	27.9
Plan amendments	-	-	-	-	-	5.9	-	-	-	-
Amortization of adjustments	106.5	99.7	87.1	159.7	30.3	(31.2)	(40.3)	(31.8)	(55.3)	(26.1)
Change in valuation adjustment	-	-	(15.5)	(3.3)	(0.5)	(0.1)	2.3	(1.5)	(2.0)	(2.0)
Total pension expense	**287.4**	**290.0**	**321.4**	**323.1**	**154.5**	**101.1**	**109.9**	**108.4**	**124.2**	**90.4**

2.139 Table 2.42 highlights the significant increase in the annual pension expense over the ten year period as well as the volatility of the expense. In the year ended 31 March 2003, the pension expense was $90.4 million. By way of contrast, in the year ended 31 March 2012, the pension expense was $287.4 million, an increase of $197 million since 2003.

2.140 Table 2.43 compares the annual pension expense to the amount of contributions made by the Province to the various pension plans.

Table 2.43 - Pension Expense and Contributions

Pension Expense and Contributions ($ millions)										
	2012	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**
Pension expense	287.4	290.0	321.4	323.1	154.5	101.1	109.9	108.4	124.2	90.4
Employer contributions	327.0	313.3	307.8	288.6	272.8	257.7	236.4	223.2	214.8	100.9
Excess (deficiency) of employer contributions over pension expense	39.6	23.3	(13.6)	(34.5)	118.3	156.6	126.5	114.8	90.6	10.5

2.141 Table 2.43 shows that for two of the past five years, the Province has not made enough contributions to its various pension plans to cover the annual pension expense, whereas for eight of the past ten years the amount of employer contributions exceeded the amount of the pension expense.

2.142 We also review the change in the employer's share of pension benefits earned (as noted in Table 2.42). The employer's share of pension benefits earned has increased at an annualized rate of 6.2% per year. This is the core component of pension expense the Province incurs to provide pension benefits earned by employees during the year.

Pension Assets Rates of Return

2.143 The net interest component of the pension expense depends primarily on the rate of return earned on pension fund assets. These returns are volatile, as illustrated in Table 2.44 which reports the rates of return for the New Brunswick Investment Management Corporation (NBIMC) since it diversified the pension funds on 31 March 1997. The NBIMC manages the trust funds for the Province's larger pension plans including the *Public Service Superannuation Act* (PSSA) plan, the *Teachers' Pension Act* (Teachers') plan and the *Provincial Court Act* and *Provincial Court Judges' Pension Act* (Judges') plan.

Table 2.44 - NBIMC Rates of Return

NBIMC Rates of Return			
Year	**Percentage**	**Year**	**Percentage**
2012	5.00	2004	25.27
2011	10.42	2003	(6.95)
2010	19.94	2002	3.45
2009	(18.34)	2001	(5.23)
2008	0.79	2000	20.57
2007	8.68	1999	(0.62)
2006	15.87	1998	18.68
2005	8.51		
15 year average annualized return			**7.07**

2.144 The returns earned by the NBIMC have ranged from a high of 25.27% in the year ended 31 March 2004 to a low of (18.34)% in the year ended 31 March 2009. Over the fifteen fiscal years the average annual rate of return of the NBIMC has been 7.07%, which is slightly above the 6.96% rate of return assumed by the Province on the significant portion of plans in the 2011-12 financial statements. The accounting required for the Province's pension plans remains subject to estimates and the financial statements continue to remain exposed to volatility, although as seen in Table 2.44 less volatility has been experienced in the last two years.

Importance of Thorough Review of Assumptions

2.145 We note for the 2011-12 financial statements the Province changed the assumed rate of return used for accounting purposes on the significant portion of plans to 6.96%. For a significant portion of the pension plans, this is the first change in this rate since the 31 March 2010 financial statements when a rate of 7.12% was used.

2.146 We continue to emphasize the importance of a thorough review of the assumptions used in the accounting for pension plans, as assumptions used should reflect management's best estimates of future events, and changes in assumptions may cause significant changes in results reported. Supporting rationale for the assumptions selected should be well documented.

Pension Accounting Adjustments

2.147 Table 2.45 provides the history of the Province's pension balance for accounting purposes and the important components involved in the calculation over the past ten years.

Table 2.45 - Components of the Pension Balance for Accounting Purposes

Components of the Pension Balance for Accounting Purposes ($ millions)										
	2012	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**
Estimated accrued benefit obligations	9,318.3	8,895.7	8,570.2	8,642.5	8,289.3	7,865.5	7,324.5	6,719.6	6,380.9	5,983.7
Value of plan assets	8,674.7	8,387.0	7,703.1	6,512.4	8,024.1	8,030.5	7,449.3	6,521.7	6,086.5	4,926.3
Pension position before accounting adjustments	643.6	508.7	867.1	2,130.1	265.2	(165.0)	(124.8)	197.9	294.4	1,057.4
Accounting adjustments	(903.1)	(728.6)	(1,063.7)	(2,340.3)	(509.9)	38.6	155.0	(41.2)	(22.9)	(695.3)
Pension balance for accounting purposes	(259.5)	(219.9)	(196.6)	(210.2)	(244.7)	(126.4)	30.2	156.7	271.5	362.1

2.148 The pension balance for accounting purposes is calculated by comparing the market value of plan assets to the actuarial estimate of accrued benefit obligations owing to present and future pensioners. From this difference an adjustment is made for accounting purposes. The purpose of the accounting adjustment is to reduce the volatility by allowing actual results achieved on plan assumptions to be reported over time and not all reported in one year. Table 2.45 provides the details of these three components of the pension balance.

2.149 Table 2.45 shows that the Province's pension position before accounting adjustments declined in the year ended 31 March 2012. This decrease was primarily due to decreased pension plan asset returns. The value of the estimated pension obligations before accounting adjustments exceeded the value of plan assets for the past five years. Table 2.45 shows pension obligations before accounting adjustments exceed pension assets by $643.6 million at 31 March 2012.

2.150 The accounting adjustment row is a critical part of pension accounting because it assumes a long term view, that the pension plan will be in existence over the long term and there will be volatility from year to year. Therefore, accounting standards permit for the smoothing of this volatility. Such adjustments for accounting purposes are allowed to be deferred and amortized into operating results in future years. Because the accounting adjustments are due to experience deferrals, the pension balance is in a negative liability position (presented in the Province's financial statements as a surplus) of $259.5 million at 31 March 2012.

2.151 As at 31 March 2012 the balance of accumulated experience adjustments (losses) for accounting purposes that were deferred and required to be amortized in future years totalled $903.1 million. Such deferral balances from experience adjustments are common in pension accounting. While the cause of the experience adjustments may result from many factors, it is a general indication that assumptions used in pension calculations did not match actual events. This accounting adjustment balance is also an indicator of the magnitude of the amount that must be recognized as an expense over time in future years. This again highlights the need for a thorough review of pension assumptions used for accounting purposes to ensure they are as realistic or as reasonable as possible.

Pension Plan Audits for Significant Plans

2.152 For the year ended 31 March 2012 the Province contracted an audit to be performed on certain financial statement elements of the larger pension plans, but not the entire plan. The audit was not completed in time to be of use for the audit of the Province, and our Office again performed extra work to compensate. This lack of timely information also raises concerns about plan transparency and sufficiency of reporting to stakeholders, including plan members.

Transparency and Stakeholder Reporting

2.153 Further to our concern noted above regarding transparency and stakeholder reporting, we note the performance reporting to plan members and other stakeholders for the largest provincial pension plans could be improved. The NBIMC reports to stakeholders on asset performance of the larger provincial pension plans, but there is little reporting on the overall plan performance including funding and sustainability challenges and other member concerns. A robust oversight, public reporting and stakeholder communication strategy is lacking for some provincial pension plans, particularly for the Province's largest pension plans.

Pension Reform

2.154 We note accounting changes may be required as part of the announced pension reforms for the Province's 2012-13 financial statements. Depending on the details of these changes, there may be financial reporting adjustments required in the Province's financial statements. We encourage early consideration of any accounting and reporting changes required. At the time of writing, we have not yet begun our audit work in this area.