

Chapter 2

Comments on the Financial Statements of the Province

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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 and by 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 1997 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 almost eight weeks earlier than the previous year.

2.7 Further changes have taken place in the composition of the reporting entity, but hospitals continue to be excluded.

2.8 There are a number of important accounting issues that the Province should be addressing.

2.9 The government is becoming more involved in leasing buildings instead of constructing them. The change carries accounting and financing implications.

2.10 Costs of highway construction have been recorded as property held for resale at year end in anticipation of a highway lease.

2.11 Government borrowing cost and the net debt balance have fallen for the past two years.

2.12 The Province recorded its second consecutive annual surplus.

The Province met its target for early release of its financial statements

2.13 The 1996-97 financial statements were issued on 13 August, an improvement of almost eight weeks over 1995-96 and an improvement of over eighteen weeks on the 1994-95 year. These are significant improvements!

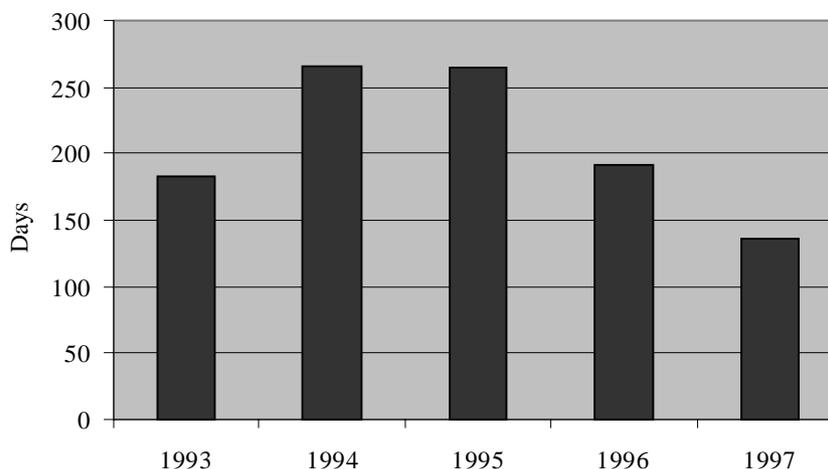
2.14 For several years we have focused on the need for the earlier issuance of the Province's financial statements to the public. We expressed concern that there was no commitment by the Province to complete its financial statements in a timely manner. We pointed out there are significant benefits not only to the users of the financial information but also to those involved in the preparation of the financial information if the financial statements are issued consistently on a timely basis.

2.15 The Province responded in 1996-97 by setting a deadline of 31 August for the issuance of the audited financial statements. That deadline was surpassed by over two weeks.

2.16 The number of days between the end of the fiscal year and the issuance of the financial statements for each of the past five years is shown graphically below.

Exhibit 2.1

Number of days between the end of the fiscal year and the issuance of the financial statements



2.17 It is not a simple matter to advance the issue date of the financial statements, particularly in the year of change. Although the Comptroller's Office has the responsibility for preparing the statements, a large number of people in the departments and agencies of government are also involved in the process which supports the preparation of the financial statements.

2.18 The changes made to facilitate the earlier release were significant. The procedures normally followed at year end were altered, leaving less time for preparing and adjusting the financial information used in the statements. Such changes undoubtedly had an effect on work plans and priorities of government staff.

2.19 The impact on our Office was also significant. In each of the last two years, as the deadline for the completion of the audit was set earlier, our audit plan for the Province had to be compressed into much shorter periods. A major effort was put forward by our staff to see that these important deadlines were achieved in spite of the reductions in the available time.

2.20 None of the positive changes would have taken place without the will of government to either allow it or promote it. The government fulfilled its role by instructing staff to issue the financial statements no later than 31 August.

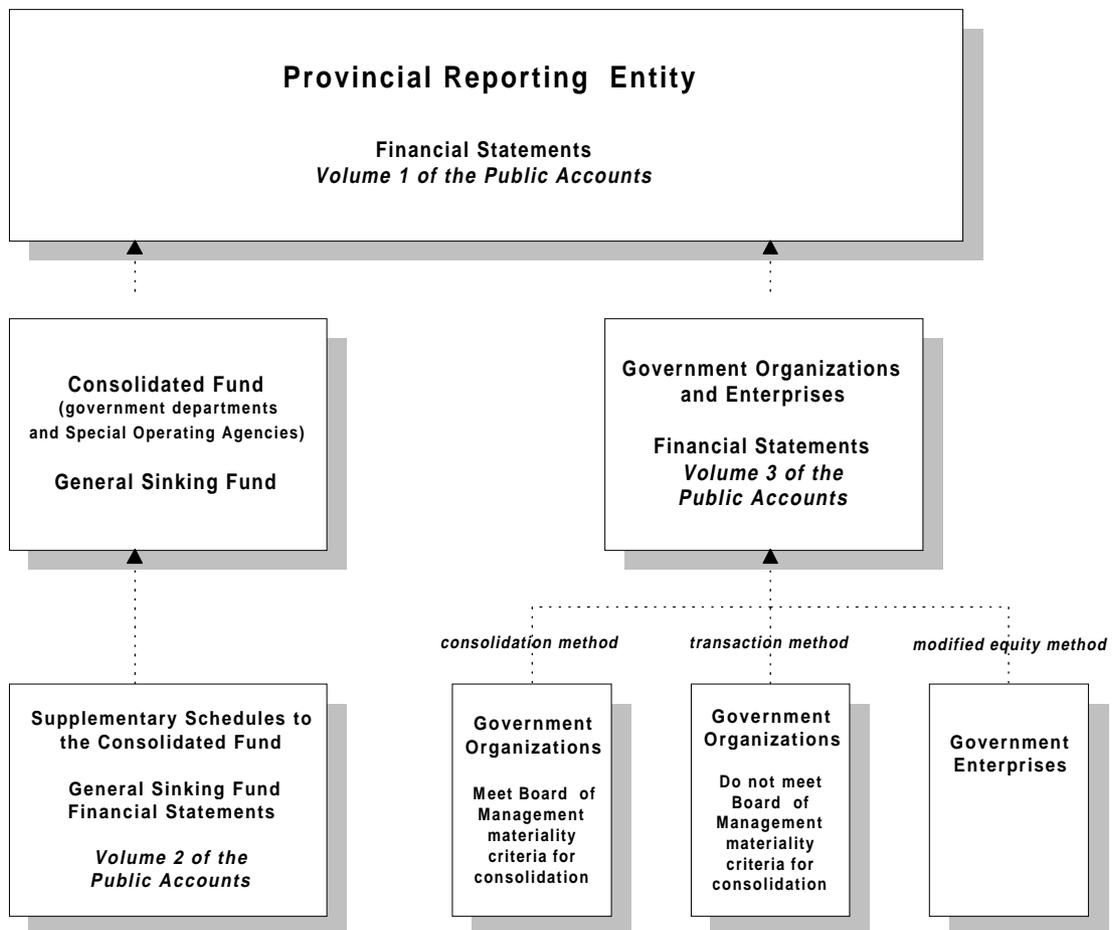
2.21 In our Reports of previous years, we pointed to a goal of issuing the financial statements within three months after year end. We continue to believe this is reachable and we are prepared to cooperate in any way to meet this date should government set this as its goal.

Comments on the composition of the provincial reporting entity

2.22 The term provincial reporting entity is used to describe the combination 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(a) to the financial statements lists the organizations included in the reporting entity and describes the method of accounting through which they are included.

2.23 Exhibit 2.2 provides an overview of the composition of the provincial reporting entity.

*Exhibit 2.2
Composition of the provincial reporting entity*



2.24 The consolidation, transaction and modified equity methods of accounting are defined in Note 1(a) to the financial statements. The Board of Management criteria for consolidation establish a cut-off point for smaller organizations which, due to their size, are accounted for simply on the transaction basis rather than line-by-line consolidation.

Changes in the reporting entity

2.25 The New Brunswick Credit Union Deposit Insurance Corporation and NB Agriexport Inc. were both added to the list of government organizations included through consolidation. The operating results of these organizations are thus included in the reporting entity.

2.26 The New Brunswick Biotechnology and Technological Innovation Centre of Excellence Inc. is no longer classified as a government organization. This change results from a modification in the composition of the corporation's board of directors such that the corporation is now independent of government.

New Brunswick school districts

2.27 Note 2 to the financial statements explains that during the 1996-97 fiscal year, the method of accounting for New Brunswick school districts was changed from the transaction to the consolidation method. This change was due to the dissolution of publicly elected school boards, which resulted in the school districts being directly accountable to the Minister of Education. We reported last year that, although the effective date of the changes to the school boards was 1 March 1996, the administrative and financial structure of the school boards was retained and continued until 30 June 1996. For this reason, the change in reporting the school board accounts did not take effect until the 1996-97 year.

2.28 This change means that all assets, liabilities, revenues and expenditures of provincial school districts are now included in the Province's financial statements. In addition, an adjustment to opening net debt as at 1 April 1996 of \$9.7 million was made. This reflects the difference between the school board expenditures recorded up to 1995-96 and the estimated amount that would have been recorded using the new method of accounting.

Hospital corporations

2.29 Note 1 to the Province's financial statements explains that hospital corporations do not meet the accounting criteria for inclusion in the provincial reporting entity.

2.30 Because only transactions between the Province and the corporations are reflected in the Province's financial statements, any deficits or surpluses in the corporations (and the related borrowing or surplus funds) are not included. A review of the corporations' financial statements shows total current liabilities exceed current assets by \$35.2 million at 31 March 1997. In addition there is total long-term borrowing of \$6.9 million and capital lease commitments of \$2.3 million. These net liabilities, amounting to \$44.4 million, are not recorded or reflected in the Province's financial statements or notes. Last year we reported that net

liabilities of hospital corporations were \$32.7 million, meaning an increase of 36% took place during the past year. The largest component of the increase was the Atlantic Health Sciences Corporation (Region 2). The amount by which its current liabilities exceeded current assets increased by \$8.5 million.

2.31 There are long-term investments of \$26.4 million contained in five of the corporations' financial statements, an increase of \$2.7 million over last year. We understand the use of these investments is restricted.

2.32 The governing boards of hospital corporations are responsible to the Minister of Health and Community Services who, in turn, is accountable to the Legislative Assembly. It is the responsibility of the governing board of each corporation to manage the resources allocated by the provincial government. These boards consist of approximately sixteen members of which one-quarter are appointed by the Minister of Health and Community Services.

2.33 The government has dealt with many important accounting issues over the past few years. A significant issue that has not been fully addressed is the accounting for New Brunswick hospital corporations.

2.34 As recently as June 1996 the Public Sector Accounting and Auditing Board (PSAAB) stated the following:

...most universities and hospitals - with the exception of those operating as part of a government department - would be excluded from the government entity.

2.35 These comments may have led to the hospitals being excluded from the provincial reporting entity in some jurisdictions. Later in 1996 changes were made to the PSAAB recommendations. They no longer refer to the fact that most hospitals would be excluded from the reporting entity.

2.36 PSAAB offers some specific guidance for determining whether organizations should be included in the reporting entity. Organizations must be owned or controlled by government and they must be accountable to a minister of government or directly to the legislature.

2.37 Factors to be considered relative to hospital corporations are:

- the hospital corporations must operate within the budget approved by the Minister of Health and Community Services;
- hospital corporation bylaws have no effect until approved by the minister;
- the hospital corporations are required to submit an annual report to the minister;

- the Lieutenant Governor in Council may, where circumstances warrant, appoint a trustee to assume the responsibilities of a hospital board;
- the Hospital Act refers to ownership by the Province of hospitals and hospital assets (although it acknowledges that not all existing hospitals are owned by the Province). Land, buildings and building service equipment are entrusted to the hospitals;
- control may be implied by the fact that the hospitals derive more than 80% of their revenue from the Province; and
- ownership and control of the hospitals may have been established when the Minister of Health and Community Services directed the administration of the hospitals during a time of reorganization when there were no hospital boards.

2.38 We are not convinced that the present method of accounting for hospital corporations in New Brunswick is the most appropriate. We intend to continue discussions with the Comptroller on this subject over the coming year.

1996-97 approved spending

2.39 An appropriation is defined as an amount that is approved by vote of the Legislature. The appropriation for the 1996-97 year has several components. These components combine to show the total allowed level of spending for the departments and agencies for the year. The components include:

- the main estimates;
- supplementary estimates; and
- special warrants.

Ordinary account spending

2.40 Over the past several years departments have received increasing flexibility to manage ordinary account spending. We have reported on these changes each year. Currently, departments may move their approved funding among ordinary account programs without seeking a supplementary appropriation. Therefore, ordinary account programs may be overspent so long as the total departmental spending on ordinary account falls within the budget.

2.41 This moving of funds is done at the discretion of the department unless the cumulative amount of such transfers exceeds \$1,000,000 or 15% of the budget for the program. When the need to make such a transfer occurs, the quarterly report submitted to the Board of Management must identify the amount of funds to be transferred and the implications of the transfers on the delivery of service. The Board's approval of the quarterly report serves as the authorization for the funding transfer.

2.42 The following exhibit shows the number of departments and programs requiring transfers of funding approval, together with the amount (in millions of dollars) of the transfers on a comparative basis.

Exhibit 2.3
Funding transfers

	1997	1996	1995
Number of departments	13	10	16
Number of programs	22	18	24
Amount	\$19.9	\$13.2	\$10.6

Capital account spending

2.43 Last year we reported the change in capital spending approval which allowed departments to move funds between programs for the first time in 1995-96. Two departments used this provision in the current year to transfer funding approval of \$4.3 million between programs. This compares to the prior year where three departments transferred funding approval totalling \$5.4 million between programs.

Total spending

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

Exhibit 2.4
Expenditure appropriations
(millions of dollars)

	1997	1996	1995	1994	1993
Main estimates	4,445.0	4,365.6	4,284.1	4,297.1	4,487.4
Supplementary estimates	4.2	45.6	76.1	63.5	31.1
Special warrants	37.8	81.3	0.2	0.3	23.5
Total expenditure appropriated	4,487.0	4,492.5	4,360.4	4,360.9	4,542.0

2.45 At the time of drafting this Report expenditure totalling \$26.8 million has not yet been approved either by way of a special warrant or supplementary estimates. We are therefore required to report that appropriations have been exceeded by this amount.

Net budgeting

2.46 The Financial Administration Act gives the Board of Management the authority to allow net budgeting. Net budgeting is a tool which 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 by the Office of the Comptroller on a quarterly basis.

2.47 The Main Estimates provide details regarding the source and amount of the revenue for each net-budgeted program. As well, for reporting purposes, both the revenue and expenditure of these net-budgeted programs is included in the financial statements, ensuring they are properly reflected in the Public Accounts.

2.48 The following list includes all approved net budgeted programs as of 31 March 1997 and provides a comparison of the amounts expensed within each program.

Exhibit 2.5
Net budgeting
 (millions of dollars)

Department	Program Description	Gross Expenditure	Revenue Netted	Net Expenditure
Advanced Education and Labour	Student Aid Administration	1.4	0.5	0.9
Advanced Education and Labour	Advocacy Programs	0.5	0.5	-
Advanced Education and Labour	Employment Development Grants	28.5	8.2	20.3
Economic Development and Tourism	Advertising Revenue	12.5	0.2	12.3
Economic Development and Tourism	Connect NB	2.2	0.5	1.7
Economic Development and Tourism	Snowmobile Fees	0.1	0.1	-
Fisheries and Aquaculture	Training Course Fees	0.2	0.2	-
Human Resources Development - NB	Family Support Orders Service	182.3	1.4	180.9
Natural Resources and Energy	Firearm Safety Training	4.8	0.1	4.7
Solicitor General	Adult Institutional Services	14.1	0.6	13.5
Total		246.6	12.3	234.3

Carry-over of unspent appropriations

2.49 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.

2.50 Board of Management approved an expenditure rollover of \$6.0 million in total from 1996-97 to the 1997-98 fiscal year for the four Special Operating Agencies described in Note 5(e) of the Province's financial statements. The Board also approved the carry-over of unexpended capital funds in the amount of \$21.6 million for the Department of Transportation.

Unresolved issues affecting accounting policies

2.51 There are several matters relating to the Province's accounting policies which are unresolved and have not been satisfactorily addressed in the financial statements of the current year. In most cases recommendations of the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants (CICA) have been in place for some time. In one case there is an issue on which there has recently been a pronouncement by PSAAB. Although, as explained below, we have provided a positive opinion on the financial statements, we believe collectively these are significant issues which should be dealt with by the Province in the preparation of its annual financial statements.

Retirement allowances

2.52 As we stated last year, the failure to properly account for retirement allowances represents the most significant issue still outstanding. These allowances are not payable by the Province at 31 March 1997. However, the liability for these allowances is incurred as

the employees of the Province work each year towards their retirement. The logic for recording the liability and the expense each year for these allowances is similar to that for recording the Province's pension liabilities. In the past we were informed that the primary reason for not recording the liability for retirement allowances was the lack of accurate data to support its calculation.

2.53 We discussed this with the Comptroller. He indicated that during the 1997-98 year he hopes to assemble the information which could be used in support of a possible adjustment to the Province's financial statements.

Accrual of teachers' salaries

2.54 Note 2 to the financial statements explains that during the year ended 31 March 1997 the Province changed its method of accounting for New Brunswick school districts from the transaction method to the consolidation method. This followed the dissolution of the public school boards on 1 March 1996. The former school districts are now accountable to the Minister of Education.

2.55 School teachers have an agreement with the Province which allows them to be paid in every month of the year, despite the fact that the school year covers only ten months. This is made possible by dividing the salary earned, in the ten months, into amounts that can be paid to the teachers over a twelve-month period.

2.56 Based on our review of the agreement between the teachers and the government, the amounts paid to the teachers are in fact earned in the ten-month period. As a result, the salaries earned by the teachers exceeds, by a significant amount, the salaries paid as at 31 March of each year.

2.57 In our opinion, the Province's financial statements should record the amount of salaries earned to 31 March rather than the amount of salaries paid out to that point in time.

2.58 Given the changes to the accounting for the former school districts in 1996-97, we expected an accrual to be made for salaries earned but unpaid at 31 March 1997. This was not done.

2.59 The matter has again been discussed with the Comptroller. Because of the nature of the teachers' salaries that are paid in the summer months, the Comptroller is currently considering them to be of a similar nature to vacation entitlements. At the present time no accrual of salary is expected to be recorded in the 1997-98 year.

2.60 The Comptroller is looking at the whole area of unrecorded employee benefits.

Vacation entitlements

2.61 Government employees earn vacation entitlements for each month of employment. At 31 March each year there are vacation entitlements

that have been earned but that have not been taken by the employees. Such entitlements have a value but, as explained in Note 1, no accrual of the expenditure has been recorded.

2.62 We have discussed this with the Comptroller and he indicated that during the 1997-98 year he hopes to assemble the information, which could be used in support of a possible adjustment. However at the present time no accruals are expected to be recorded in the 1997-98 year.

Liability to injured workers

2.63 The Workplace Health, Safety and Compensation Commission of New Brunswick assumes the responsibility for payments to injured workers. Only a portion of the liability for future benefits to workers who are currently injured has been recorded in the financial statements of the Province.

2.64 The Comptroller indicated he would review this issue in the 1997-98 year.

Summarizing the impact of the preceding four issues

2.65 The estimated impact on the financial statements of these matters is as follows.

*Exhibit 2.6
Estimated impact of unresolved issues on provincial financial statements*

	(in millions of dollars)	
	Impact on net debt	Impact on 1997 expenditure
Retirement allowances	150-200	negligible
Teachers' salaries	46	negligible
Vacation entitlements	10-20	negligible
Liability to injured workers	29	0.7

2.66 Adjustment for all of these issues on the 1997 financial statements (using the estimated amounts shown above) would have a large impact on net debt. However the effect on the expenditures of the 1996-97 year would be small.

2.67 The Province's method of accounting for each of the preceding four issues has been explained in Note 1 to the financial statements.

2.68 **It is our opinion that the each of the four matters should be properly reflected in the Province's financial statements and we recommend that the information necessary to make the adjustments be obtained as soon as possible. We would like to see the appropriate entries made in the 1997-98 year.**

Concessionary loans

2.69 For the past two years we raised the issue of concessionary loans. These are defined as loans which have low interest rates, extended repayment terms or forgiveness clauses. When a loan is not required to be fully repaid, including interest charged at market rates, there is a cost

incurred by government. The cost must be recognized and accounted for in the proper accounting period and the loans must be correctly valued.

2.70 We reported that the Province does not account for the concessionary loans in compliance with PSAAB recommendations.

2.71 Following our meeting with the Comptroller last year we were informed that finalizing the Province's policy at that time would be premature and we reported that the Comptroller would be addressing the issue in 1996-97.

2.72 The progress in this area was discussed with the Comptroller. He indicated that his staff continues to work on this issue. We would like to see the issue resolved in the 1997-98 year.

Tangible capital assets

2.73 PSAAB has recently approved accounting and reporting standards for the tangible capital assets held by provinces. These assets include land, buildings, equipment, roads, bridges etc. They are defined by PSAAB as non-financial assets having physical substance that are acquired, developed or constructed and:

- are held for use in the production or supply of goods and services;
- have useful lives extending beyond an accounting period and are intended to be used on a continuing basis;
- are not intended for sale in the ordinary course of operations.

2.74 The implications of these standards are significant for the Province. Some of the changes that would take place in the Province's financial statements are as follows:

- A new financial statement called the statement of tangible capital assets would be prepared and included with the three financial statements currently issued by the Province. The new statement would account for the asset balance and the changes to the net asset balance in the year. The year's amortization of the cost of the assets would be disclosed, as would the accumulated amortization to the end of the year.
- Disclosure requirements will include the amortization method used, the net book value of assets being amortized and the amount of interest capitalized.

2.75 PSAAB recommends the adoption of the standards as soon as practicable. It indicates that both new and existing assets should be accounted for in this manner. The standard was issued after the release of the Province's statements for the 1996-97 year so the first opportunity to release a financial statement under the new format would be the 1997-98 year.

Government has leased a school and a correctional facility

Traditional approach to real estate leases

How the leasing practices have changed

Impact of leasing versus constructing

2.76 This was discussed with the Comptroller. He indicated he fully supports PSAAB's recommendations about tracking and recording tangible capital assets. However, because PSAAB's recommendations on tangible capital assets do not affect annual results, the Comptroller indicated that work on this issue will be deferred until the issues of concessionary loans and employee benefits have been resolved.

2.77 Real estate leases are not new to the Province. They have been used for years as a means of providing office space. The nature of the real estate leases in which the Province has become involved, however, has changed.

2.78 The Province extensively leases space in buildings owned by the private sector as a means of providing the office space needed for its employees. The terms over which these leases run vary from just a few years to twenty years. Some of the leases are for entire buildings while others are for portions of buildings. The lease costs are normally calculated on a per square foot per year basis.

2.79 Until recently, hospitals, schools and correctional facilities were not among the types of buildings leased by the Province. The Province was directly involved in both the design and the construction of all new facilities of this nature. The costs of construction were recorded as expenditures when they were incurred.

2.80 In our last Report we pointed to the fact that two major lease agreements had been signed. A lease for a public school facility was signed during 1995-96 and a lease for a correctional facility was signed subsequent to the 1995-96 year end. Both agreements featured twenty-five year lease terms with a purchase option at the end of the twenty-five year period. The Province must renew the leases for a further ten years at the conclusion of the initial term if the purchase option is not exercised.

2.81 These two new leases differ from those signed in the past:

- the terms of these leases are longer;
- the Province has the opportunity to purchase the facility as part of the lease agreement; and
- the Province plays a greater role in determining how the facilities will be constructed.

2.82 Leasing rather than constructing these types of facilities results in significant changes to the Province's finances and accounting.

- **Recognition of the cost** - the cost is recorded over the lease term rather than recording the cost in the period of construction.
- **Cash flow** - the funds required to pay for the use of the facility are paid out over the term of the lease rather than during the period of

construction. This has an impact on the borrowing requirements of the Province. The immediate need for cash is eliminated and the required funds can be raised or borrowed over the number of years specified in the lease agreement.

- **Commitment** - expenditures of future years are being locked in place by signing the lease agreements.

Impact of the leases on government expenditure

2.83 Early in the 1996-97 year another lease agreement was signed. It related to a psychiatric facility that is to be constructed by the private sector and leased to the Province.

2.84 Recording these leases as operating leases rather than capital expenditure has the following impact on the Province’s expenditures. This table considers the three lease agreements signed by the end of July 1997.

*Exhibit 2.7
Impact of leases on the Province’s expenditures
(millions of dollars)*

	1997	1998	1999
Recorded as operating leases	0.8	1.6	3.5
Recorded as capital expenditure (traditional approach)	10.7	27.2	3.0
Impact on expenditures	(9.9)	(25.6)	0.5

2.85 For the purposes of the table, the capital expenditure was assumed to be incurred at the point where lease payments began.

2.86 The table shows the trend towards lower costs initially and larger amounts expensed in later years with the operating lease classification.

Accounting issues

2.87 The differences between constructing and leasing these facilities would have less significance from an accounting perspective had the leases been recorded as capital leases. For capital leases, the cost of the assets would be expensed at the beginning of the lease term. However, they have been classified as operating leases which means that the costs are recorded over the term of the lease.

2.88 There are several important considerations in relation to the classification of these leases for accounting purposes.

- Using the recommendations of the Canadian Institute of Chartered Accountants (CICA), the leases would be classified as capital leases. However the CICA refers governments to the Public Sector Accounting and Auditing Board (PSAAB) for direction in determining their appropriate basis of accounting.
- PSAAB accounting recommendations do not address the issue of leases.

- The effects of lease accounting may be less significant for private sector organizations covered by the CICA recommendations. This is because they generally depreciate the cost of their capital assets. Whether it is annual depreciation cost or annual lease cost that is recorded, the impact on the surplus or deficit is normally similar. The impact on the provincial government is very different, as we have explained.
- The Province has an accounting policy that permits the classification of real estate leases as operating leases. This policy is explained in the financial statements and it has been in existence for a number of years.
- The Province's financial statements have been prepared on a basis disclosed in Note 1 to the financial statements. Our auditor's report refers to the accounting policies disclosed in Note 1.

2.89 Note 1 to the financial statements states that long-term leases under which the Province, as lessee, assumes substantially all of the benefits and risks of ownership of leased property, are classified as capital leases. The benefits and risks of ownership of real property leases are considered to have been assumed by the Province if ownership transfers during the lease term or if the lease term is extremely long. Based on this policy, the Province has classified the leases referred to above as operating leases.

2.90 The leases in question are for a term of twenty-five years. At that point they will be either renewed for another ten years or the facilities will be purchased by the Province. However, there are no incentives or bargain purchase options available which would indicate a transfer of ownership is likely. At the end of the renewal period there is no requirement for the Province to purchase.

2.91 The effective lease terms are thirty-five years. The Province indicates that this is not considered to be extremely long for leases of this nature.

2.92 If we found that the accounting policy adopted by the Province was inappropriate or misleading we could not support its use and would take the necessary action to bring this to the attention of the reader of the financial statements. There is no basis on which to definitively say that the accounting is incorrect. In fact, the accounting treatment given to these transactions is consistent with the Province's accounting policy which is disclosed in the notes to the financial statements. The Province freely admits that under the CICA policy they would be forced to record the arrangements as capital leases.

2.93 The uncertainty over accounting for leases is not confined to New Brunswick. The issue is of concern in a number of provinces and without

action by PSAAB, the potential for inconsistency and misinterpretation will continue.

The government is planning to lease a highway

2.94 The Province has plans in place to have a toll highway constructed from Fredericton to Moncton, a distance of 195 kilometres. This is a very large project. The total cost of constructing the highway is expected to be \$600 million.

2.95 This highway will not be built by the Province or by contractors dealing directly with the Province, as has been the norm for highway construction in the past. Negotiations are under way to select a successful bidder to assume responsibility for the construction and operation of the highway. The successful bidder will lease the completed highway back to the Province.

2.96 The project to find a builder for the highway commenced with a feasibility study that was approved in June, 1996.

2.97 Three companies were then chosen to submit proposals following a call for qualifications. The technical and financial proposals from these three companies have now been received. These proposals are being subjected to extensive review before deciding on the successful bidder.

2.98 As disclosed in the notes to financial statements, the Province intends to complete a contract with one of the bidders during the fiscal year ending 31 March 1998.

Accounting implications

2.99 The Province has already incurred costs in constructing portions of this highway. The successful bidder will be required to purchase these completed portions from the Province and undertake to construct the remainder. In 1996-97 the Province spent \$38.9 million on construction and pre-construction activity related to the highway. The intention is that the successful bidder will reimburse the Province for these costs.

2.100 As a result, costs incurred by the Province in the 1996-97 year have not been expensed. Rather, they have been set up as an asset of the Province called property held for resale. When the property is sold to the successful bidder, cash will be received and this property held for resale account will be reduced to zero.

2.101 There were contributions from the Government of Canada which would normally have been recorded as revenue in the 1996-97 year. Since these funds were used to construct a portion of highway that is to be sold, it is not appropriate to record the funds as revenue in the 1996-97 year. They have been deferred and will be recognized as revenue as the Province recognizes the corresponding expenditure.

2.102 When the highway lease agreement is signed it is expected to set out a lease arrangement that will qualify as an operating lease. There are two major implications to this method of accounting.

- The first relates to when the costs are recognized in the financial statements of the Province. The operating lease classification means that the costs will be recorded over the term of the lease. Traditional methods of financing would see the costs shown as expenditure in the year when the construction takes place. The impact on the surplus or deficit will be significant.
- The second relates to the borrowing. If the lease is accounted for as an operating lease the cost of the project will not be paid for by the Province before it begins to use the facility, rather it will be paid for over the term of the lease. Therefore there will be no major borrowing required by the Province, and perhaps no borrowing at all if the lease costs can be covered by future annual surpluses. The impact of this will be that a major financial commitment will not be recorded in the liabilities of the Province.

2.103 We will be monitoring the development of this project in the 1997-98 year.

Surpluses, deficits, borrowing and net debt

2.104 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

2.105 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.

2.106 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.**

2.107 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.

2.108 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.

2.109 **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 fifteen percent of the Province's debt. This level is consistent with prior years.

2.110 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.

2.111 The Province plans for the 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.

2.112 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 fulfill 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.

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

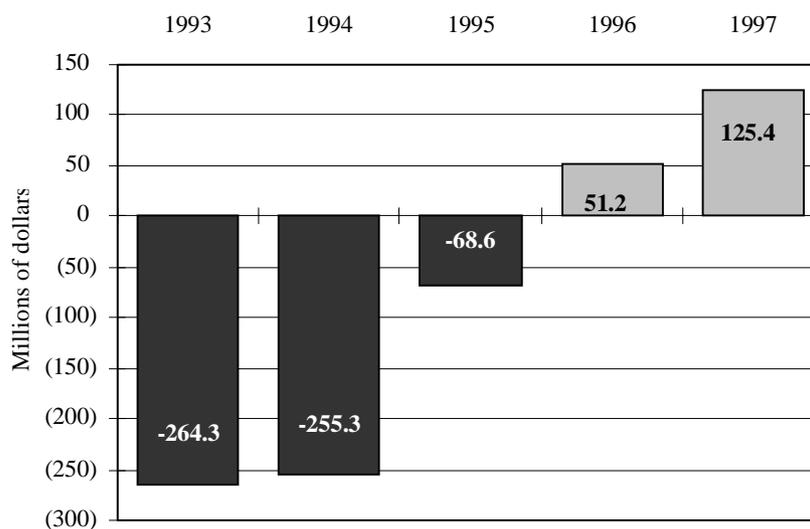
- surplus (deficit) per person and employed person in New Brunswick;
- cost of borrowing per person and employed person in New Brunswick;
- proportion of provincial revenue consumed by cost of servicing the public debt;

- comparison of the change in net debt to the change in funded debt; and
- net debt in proportion to GDP.

Surplus for the year ended 31 March 1997

2.114 The Province had a surplus for the year ended 31 March 1997 of \$125.4 million. This amount includes the surpluses and deficits of the government enterprises described in Note 1 of the Province's financial statements. Exhibit 2.8 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 financial statement presentation.

*Exhibit 2.8
Provincial surplus or deficit for the
last five years*

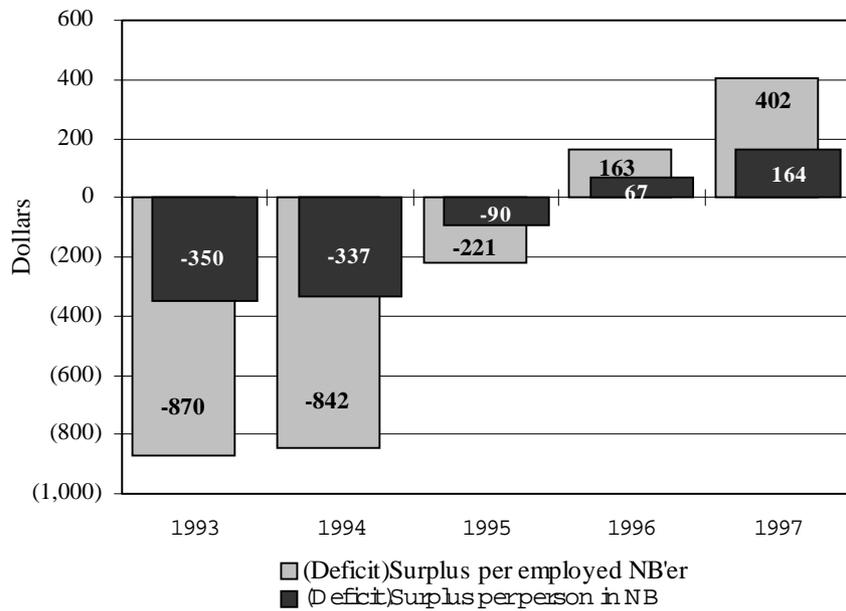


2.115 The 1996-97 surplus translates to a \$164 share for each person living in New Brunswick¹. This is in contrast to last year's surplus of \$67 per person.

2.116 Examining the surplus from the perspective of an average employed New Brunswicker might provide a better measure of its size. Exhibit 2.9 shows the amount of the surplus or deficit per person and per employed person in each of the last five years².

1. Population as at 31 March 1997 per N.B. Statistics Agency.
2. Employment figures based on annual averages for fiscal years. Data supplied by N.B. Statistics Agency.

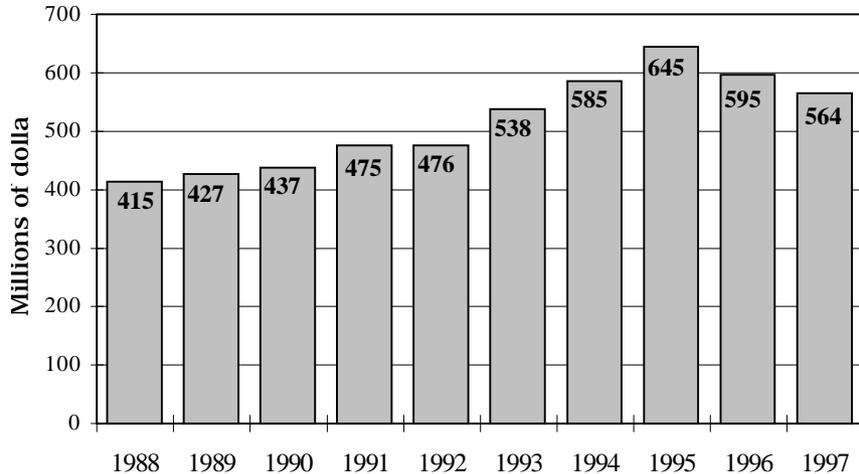
*Exhibit 2.9
Provincial surplus or deficit per person for the last five years*



Cost of servicing the public debt

*Exhibit 2.10
Cost of servicing the public debt for the last ten years*

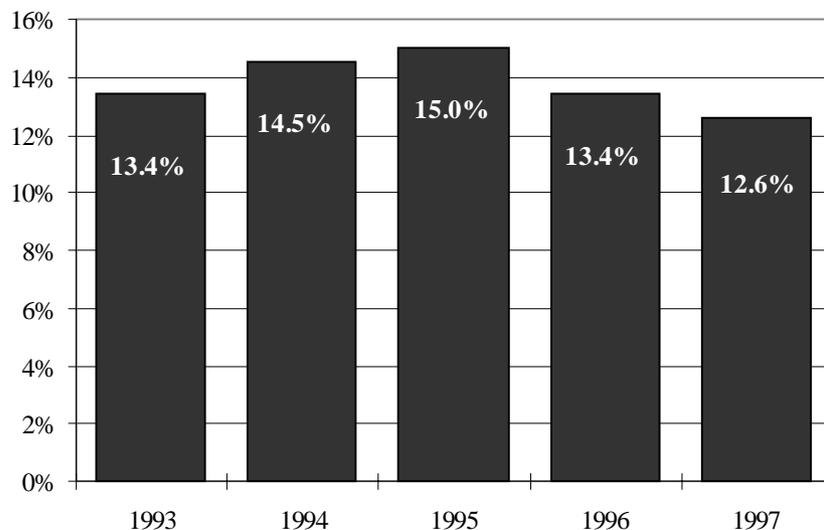
2.117 Exhibit 2.10 shows the cost of servicing the public debt by year for the last ten years.



2.118 During this period the cost of servicing the public debt has risen from a low of \$415 million to a high of \$645 million in 1994-95. This represents an increase of 55.4% over seven years. For the second consecutive year the cost of servicing the public debt has decreased. It fell to \$564 million in 1996-97, a decrease of 5.2% from 1995-96 and a decrease of 12.6% from the 1994-95 level.

2.119 Exhibit 2.11 shows the portion of provincial revenue consumed by the cost of servicing the public debt for the last five years.

Exhibit 2.11
Portion of provincial revenue
consumed by the cost of the public
debt for the last five years



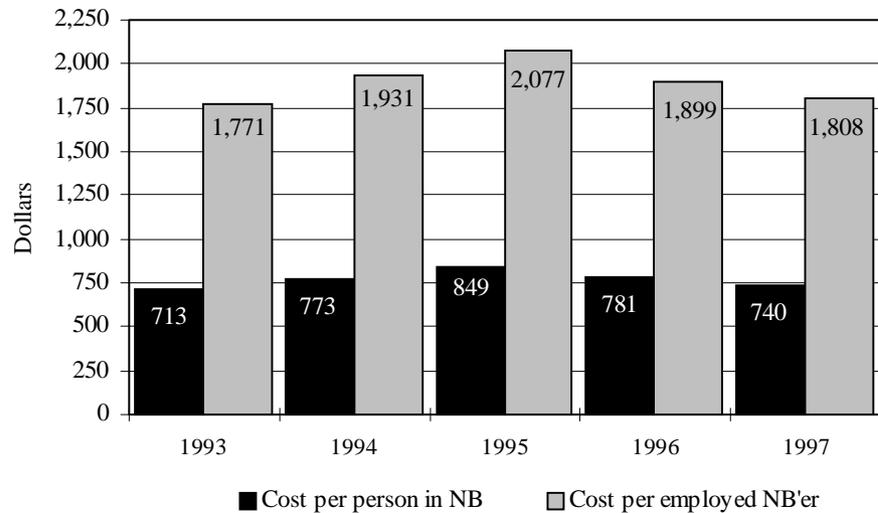
2.120 The decrease from 13.4% in 1995-96 to 12.6% in 1996-97 is the net result of a decrease in borrowing costs of \$31 million combined with an increase in revenue of approximately \$44 million. The lower borrowing costs resulted from a decrease in both interest and foreign exchange expenses. The higher revenue was mostly due to an increase in income tax revenue. If 1996-97 revenue had remained at the prior year's level, the percentage consumed by the cost of borrowing would still have decreased to 12.7%.

2.121 This year's cost of borrowing translates to \$740 for each person living in New Brunswick¹. Expressed another way, the Province's cost of borrowing for 1996-97 averages \$1,808 for each employed New Brunswicker². Exhibit 2.12 shows this relationship for the last five years.

1. Population as at 31 March 1997 per N.B. Statistics Agency.

2. Employment figures based on annual average for fiscal 1997. Data supplied by N.B. Statistics Agency.

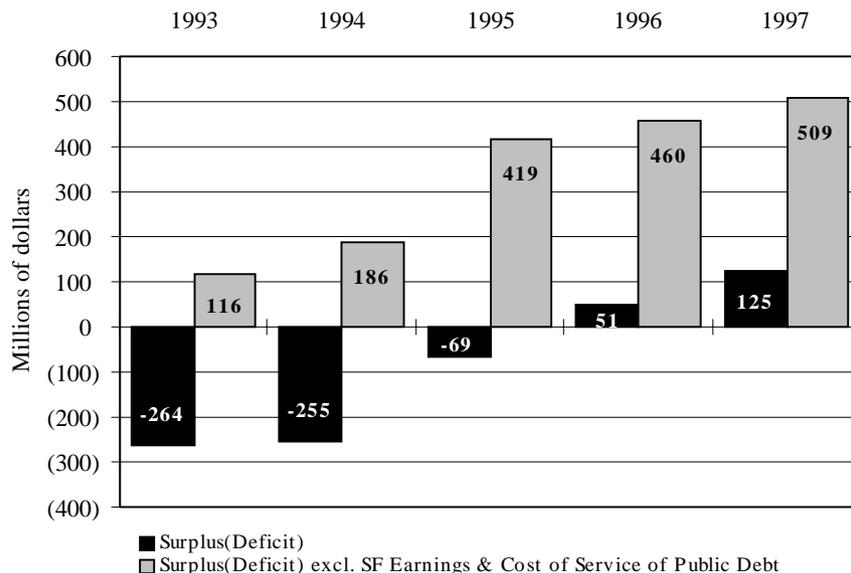
Exhibit 2.12
 Provincial cost of borrowing per person for the last five years



2.122 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 \$509 million.

2.123 Exhibit 2.13 demonstrates that the Province would have shown significant surpluses in each of the past five years had there been no cost of servicing the public debt or sinking fund earnings.

Exhibit 2.13
 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

2.124 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, expenditure when the obligation arises. However, the related cash receipts or payments may not occur in the same fiscal period.

2.125 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 18 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 \$373.6 million in 1996-97 despite a surplus of only \$125.4 million.

2.126 The components of this \$373.6 million decrease in borrowing are bank advances and short term borrowing (which decreased by \$315.5 million), long-term borrowing (which increased by \$164.7 million) and sinking fund investments (which increased by \$222.8 million). Short-term borrowing was reduced due to the receipt of Harmonized Sales Tax Adjustment Assistance. This totalled \$364 million and was received from the federal government. According to the federal-provincial agreement, this assistance reflects the foregone provincial revenue due to implementation of the harmonized sales tax system.

Long-term borrowing activity in the current year

2.127 In the past year, provincial bonds were sold with ten-year maturities. Exhibit 2.14 summarizes the activity in the funded debt for provincial purposes account during the last five years.

*Exhibit 2.14
Funded debt for provincial purposes for the last five years
(millions of dollars)*

	1997	1996	1995	1994	1993
Opening balance	6,307.8	6,288.8	5,887.6	5,358.5	4,758.7
Borrowed during the year	530.0	698.1	708.0	634.3	949.1
Debt redeemed	(312.2)	(543.9)	(412.1)	(278.2)	(427.6)
Adjustment for the change in exchange rates	(53.1)	(135.2)	105.3	173.0	78.3
Closing balance	6,472.5	6,307.8	6,288.8	5,887.6	5,358.5

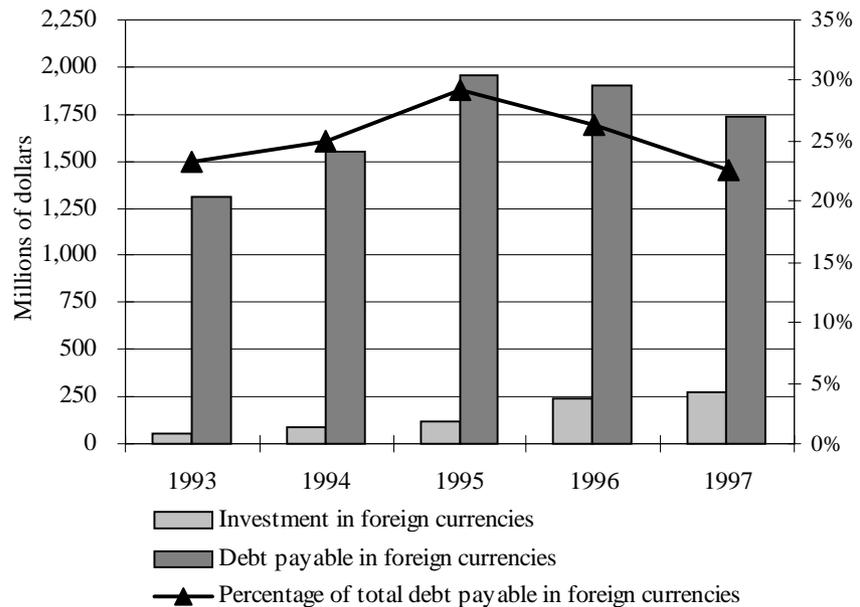
2.128 The increase in total funded debt for provincial purposes during the year is more than offset by an increase in investments of the sinking fund. During the year ended 31 March 1997 long-term debt increased by \$164.7 million while the compensating increase in the sinking fund investments was \$222.8 million. Where the sinking fund has grown by an amount exceeding the year's long-term borrowing, this could be considered to be a 'principal repayment'. As long as this trend continues, the Province will make significant progress in reducing the balance of funded debt outstanding.

Exposure to foreign currency exchange rate fluctuations

2.129 Debt repayable in foreign currencies is denominated in US dollars, Japanese yen and Swiss francs. Such debt usually requires that annual interest be paid in the same currencies as the original issue. Between 1 April 1996 and 31 March 1997 the Canadian dollar increased in value against all of these currencies. The net result was a favourable adjustment for the Province of \$53.1 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. This is the second consecutive year during which the adjustment for the change in exchange rates has reduced the amount of the provincial debt. The adjustment for exchange rate fluctuations increased the amount of the provincial debt in each of the three years preceding 1996.

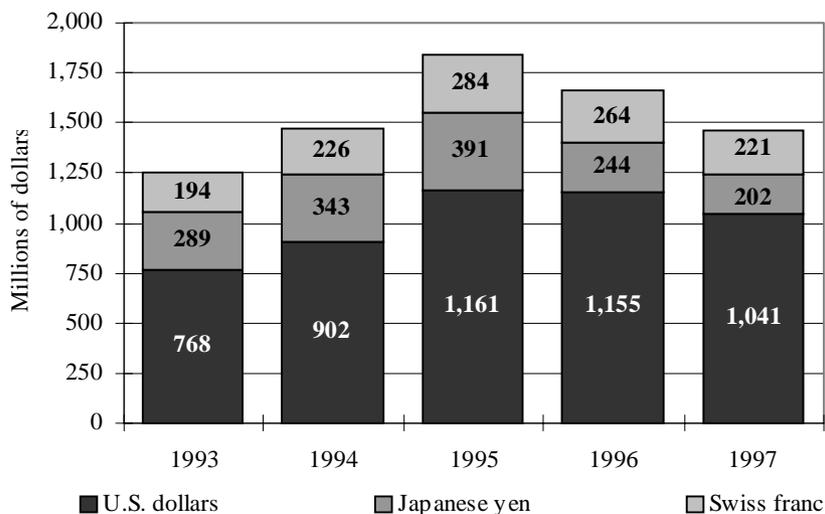
2.130 Exhibit 2.15 demonstrates the change in the Province's net exposure to foreign exchange rate fluctuations over the past five years.

*Exhibit 2.15
Net exposure to foreign exchange rate fluctuations over the past five years*



2.131 Exhibit 2.16 demonstrates the change in the components of the Province's net exposure to foreign currencies over the last five years. For the purposes of this chart, investment in a foreign currency has been deducted from debt payable in foreign currencies.

Exhibit 2.16
Changes in debt payable in foreign currencies for the last five years



2.132 The previous table shows that exposure to gains and losses due to foreign currency exchange rate fluctuations at 31 March 1997 has decreased by \$199 million from 31 March 1996. This is the second consecutive year that the Province's exposure has decreased.

2.133 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).

2.134 Note 11 of the financial statements of the Province discloses the debt that is repayable under swap agreements. This debt is excluded from the above chart and previous table except where the debt was payable in US dollars under a swap agreement.

2.135 At 31 March 1997, the Province had four outstanding forward contracts fixing exchange rates on an exposure of approximately \$34 million.

Net debt at 31 March 1997

2.136 As noted previously, net debt decreased by \$125.4 million during the 1996-97 year. The amount of net debt at 31 March 1997 stands at \$7,137 per person¹ living in New Brunswick or approximately \$17,441

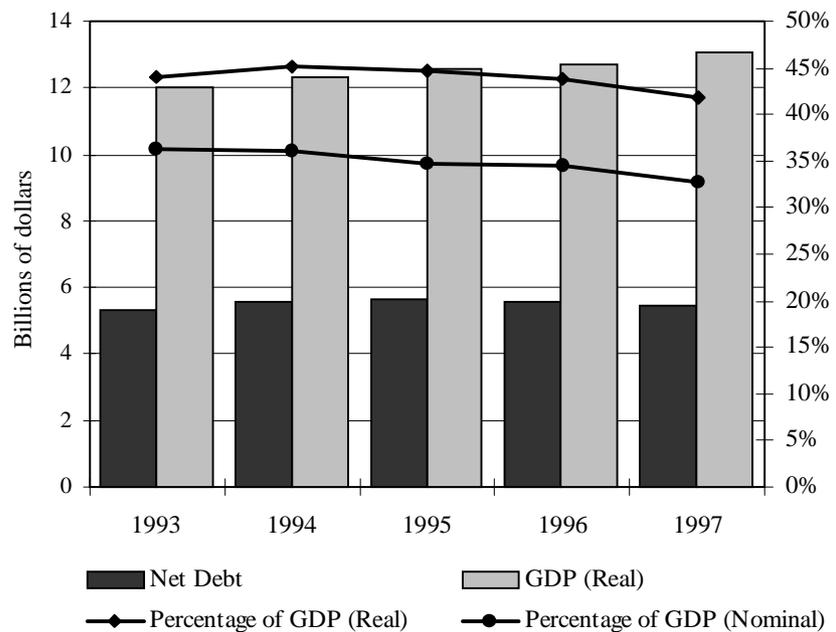
1. Population as at 31 March 1997 per N.B. Statistics Agency.

for each employed person¹ in New Brunswick. The average wage of a New Brunswicker was \$26,743² during 1996-97.

2.137 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.

2.138 The following chart shows the relationship between the Province’s net debt as a percentage of both real and nominal GDP for the last five calendar years. Both calculations are commonly used to describe the financial status of the Province. Real GDP refers to a calculation of GDP that adjusts for the effect of inflation. Nominal GDP has not been so adjusted. They have both been included in the following chart to facilitate readers’ comparison with other sources of information.

Exhibit 2.17
Provincial net debt and GDP for the last five years



Note: 1997 GDP estimate and historical GDP information obtained from N.B. Statistics Agency

1. Employment figures based on annual average for fiscal 1997. Data supplied by N.B. Statistics Agency.
2. Average wage figures based on annual average for fiscal 1997. Data supplied by N.B. Statistics Agency.

2.139 In real terms, the Province's current net debt to GDP ratio is approximately 42%. The net debt to nominal GDP results in a ratio of 33%. Real GDP is expected to increase by 2.5% in 1997 while nominal GDP is expected to increase by 3.5%.

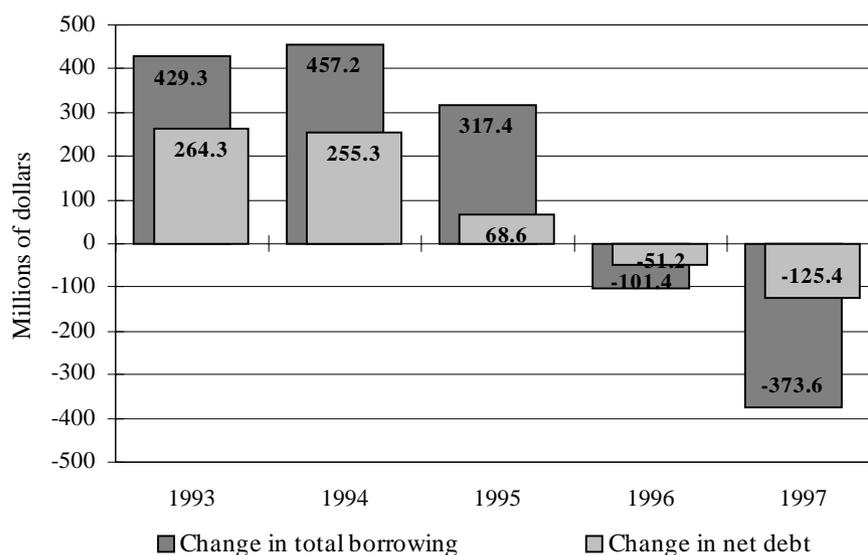
2.140 Last year we reported a modest decrease in the net debt to nominal GDP ratio between calendar 1995 and 1996. This was based on an assumption of 2.75% growth during 1996. However, that level of growth did not materialize. Rather, GDP declined slightly during 1996. This caused the net debt to GDP ratio to remain stable for 1996.

2.141 It is important to recognize that while the net debt may decrease in any given year, funded debt could still increase. This occurred during fiscal 1995-96 when net debt decreased by \$51 million. During the same year, funded debt for provincial purposes increased by \$19 million.

2.142 This is because there is a difference between the annual surplus or deficit and the annual cash requirements of the Province. Note 18 to the Province's financial statements provides information on the various components which combine to effect a change in provincial borrowing during the year.

2.143 The following chart shows the changes in the Province's net debt as well the changes in total borrowing for provincial purposes during the last five years:

Exhibit 2.18
Changes in borrowing and net debt
for the last five years



2.144 Exhibit 2.18 shows that while there may be a correlation between net debt and total borrowing, it is by no means a direct relationship.

Eliminating the net debt

2.145 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. A plan to reduce the \$5.5 billion net debt of the Province was introduced for the first time this year.

**Long-Term Net Debt
Reduction Plan**

2.146 The government introduced a long-term net debt reduction plan in May 1997. The government believes this reduction in the net debt is a crucial factor in New Brunswick becoming a self-sufficient province. The stated benefits of debt reduction include reduced spending on debt service “which would free money to reduce taxes or to provide more or better services to New Brunswickers”.¹

2.147 The goals of the long-term debt reduction plan are as follows:

- eliminate over eighteen years the \$2.5 billion in net debt incurred from previous ordinary account deficits and unfunded pension liabilities, by using surpluses to pay down the debt; and
- reduce net debt as a percentage of New Brunswick’s Gross Domestic Product from 34.9% to 9.5% by 2013-14.

2.148 The plan requires gradually increasing annual surpluses over the eighteen-year period beginning with the 1996-97 year and ending in 2013-14. Period benchmarks are set every fourth year. In order to achieve the desired reduction in net debt, a surplus of approximately \$50 million per year for the first four-year period is required. This must then accelerate by \$50 million for each four-year period thereafter.

2.149 The government first introduced balanced budget legislation in 1993. The first period covered by this legislation was 1993-94 through to 1995-96. Ordinary account expenditure could not exceed ordinary account revenue for the three-year period. The second period covered by the legislation is from 1996-97 to 1999-2000 and it covers total expenditure and revenue. Note 6 to the Province’s financial statements discloses the details of this legislation.

2.150 The government plans to amend the Balanced Budget Act to state that revenue must exceed expenditure by the scheduled amount as outlined in the debt reduction plan over each four-year period. The Minister of Finance will present a progress report on the debt reduction plan annually in the Legislative Assembly.

Comments on the plan

2.151 The government has taken a first important step toward reducing the net debt by committing itself to a course of action as defined in the plan. We have not studied the plan in detail. Our comments are based on our initial observations and discussions.

1. New Brunswick long-term debt reduction plan.

2.152 The long-term debt reduction plan is based on a number of economic assumptions including growth in the Province's GDP as well as inflation and interest rate projections. The government proposes to legislate the achievement of the plan benchmarks regardless of the affect future economic performance has on the assumptions contained in the plan. The plan does not contain detailed information on contingency plans should actual results fall short of expectations. It simply states that annual results may deviate; however surpluses will be averaged over each four-year period.

Summary

2.153 Exhibit 2.19 summarizes the impact of the Province's current financial results from the perspective of a resident of the Province of New Brunswick.

*Exhibit 2.19
Summary of provincial financial
results*

	Per person in N.B.				
	1997	1996	1995	1994	1993
Borrowing cost	740	781	849	773	713
Surplus (deficit)	164	67	(90)	(337)	(350)
Net debt	7,137	7,309	7,400	7,335	7,018

	Per employed person in N.B.				
	1997	1996	1995	1994	1993
Borrowing cost	1,808	1,899	2,077	1,931	1,771
Surplus (deficit)	402	163	(221)	(842)	(870)
Net debt	17,441	17,775	18,111	18,319	17,433

2.154 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.

Revenue and expenditure

2.155 The purpose of this section is to provide readers with useful information and analysis on which to draw their own conclusions about the Province's revenue and expenditure. It is not the purpose of this section to provide a conclusion about the appropriateness of individual types of revenue or expenditure. Such issues are matters of policy which are more appropriately dealt with by the Legislative Assembly. Accordingly, they do not fall within our mandate at the Office of the Auditor General.

2.156 The Statement of Revenue and Expenditure is a key financial document for the Province. The public, the government, and the media frequently quote facts and figures from this statement. This is because it is

one of the timeliest tools available for assessing government's performance and stewardship.

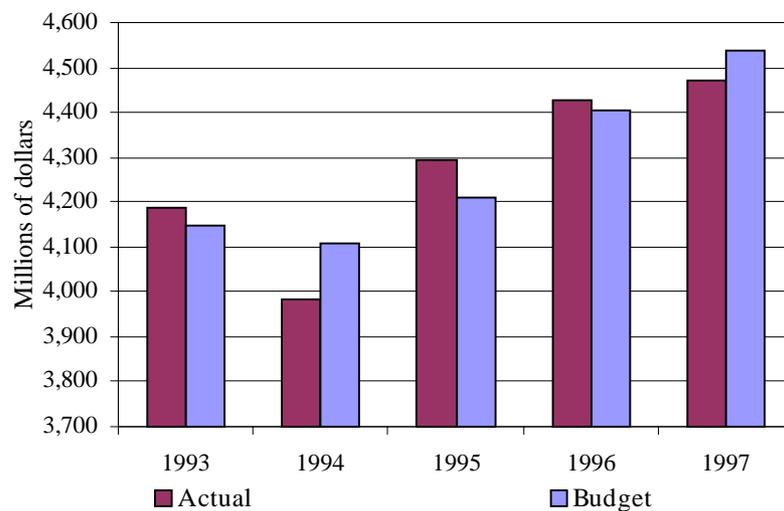
2.157 For instance, one of the chief financial indicators of performance and stewardship is the annual surplus or deficit. This figure has taken on a significantly higher profile in recent years. This is due to the widespread recognition that governments cannot continue to borrow without significant consequences for the future. This principle has been translated into provincial initiatives such as the balanced budget legislation. The Province's current financial success or failure is often measured by the amount of the annual surplus or deficit.

2.158 The financial statements go to considerable length in explaining the accounting policies, the activities and the entities which comprise the Statement of Revenue and Expenditure. Additional details can be found in the notes and schedules to the financial statements. However, some readers may find this amount of detail overwhelming. For this reason, our Report has traditionally provided a brief analysis of revenue and expenditure. It is hoped that by providing objective information on a consistent basis, readers will gain insight into financial patterns, trends, and issues.

Revenue

2.159 Overall, provincial revenue increased by \$44.2 million (or 1%) in 1996-97 over the prior year. However, Exhibit 2.20 shows that the Province anticipated more revenue than it received in 1996-97. The shortfall in revenue was \$67.4 million. A similar shortfall occurred only one other time in the last five years.

*Exhibit 2.20
Comparison of budgeted revenue to actual, by year*



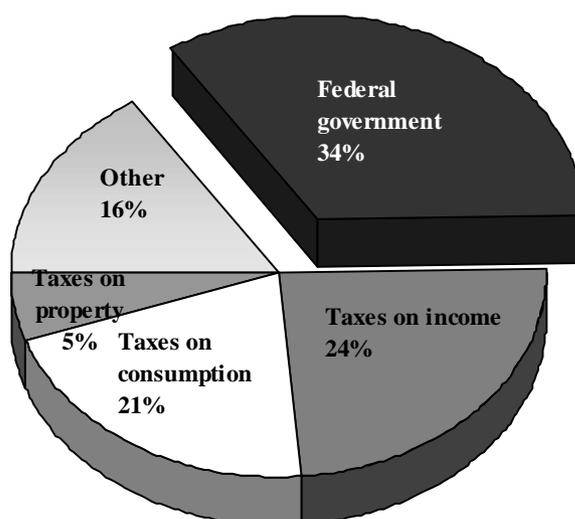
2.160 Though a \$44.2 million increase in revenue is not a large increase, it may have been a surprise to some readers. The Minister of Finance predicted a reduction of \$150 million in federal transfers during

1996-97 and 1997-98.¹ This expectation materialized, at least in part, during 1996-97. Federal transfers decreased by \$102.2 million (or 6.3%) from the prior year.

2.161 Federal transfers have been an area of considerable uncertainty for the Province during its recent history. If the provincial government is to meet its goal of making New Brunswick 'self-sufficient',² it must reduce the degree of uncertainty associated with these federal transfers. Continued uncertainty makes New Brunswick vulnerable to future federal transfer fluctuations.

2.162 New Brunswick's vulnerability would decrease if federal transfers were to stabilize in both the short and long term. Vulnerability would also decrease if New Brunswick reduced its dependence on these federal transfers. One measure of provincial dependence is shown in Exhibit 2.21.

Exhibit 2.21
Sources of revenue



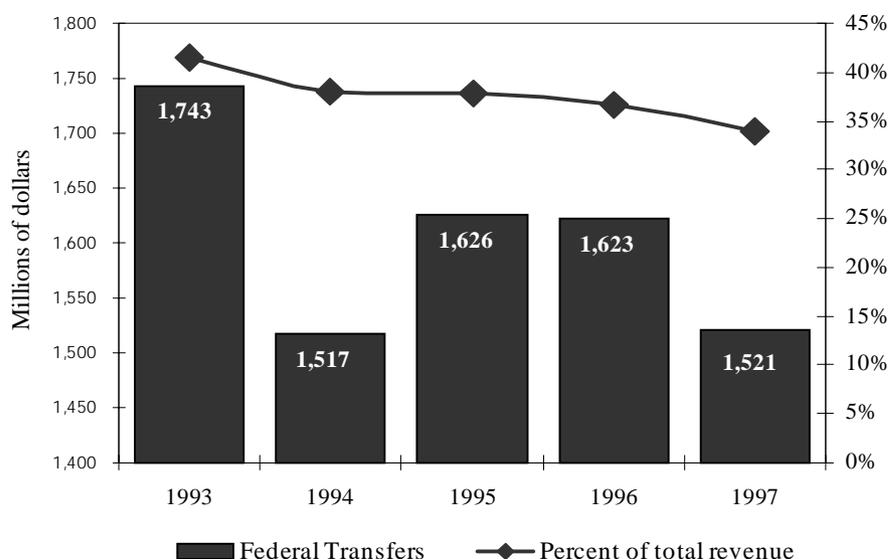
2.163 The Minister of Finance predicted in the 1996-97 Budget Speech that the percentage of total provincial revenue represented by federal transfers will fall to 34% by 1997-98. As Exhibit 2.21 shows, our Office calculates this percentage at 34% in 1996-97 (last year 37%). In this regard, New Brunswick appears to be succeeding. It is important to note that the Province enjoyed a surplus in 1996-97 despite this decrease in federal transfers.

2.164 Overall, there has been a decrease in federal transfer revenue of almost \$222 million over the last five years. This translates into a 12.7% decrease in total provincial revenue (using 1993 as a base.) Exhibit 2.22

1. Introduction, 1996-97 Budget presented by Minister of Finance.
2. 1996 Speech from the Throne; and Introduction, 1996-97 Budget presented by Minister of Finance

shows federal transfers as a percentage of total provincial revenue for the period 1993 to 1997.

Exhibit 2.22
Federal transfer revenue and
percentage of total provincial
revenue, by year



2.165 It is useful to consider these revenues from the perspective of the average New Brunswicker. In 1996-97, the Province recorded revenue of approximately \$1,994 per person¹ from the federal government to fund provincial programs and services. This is down from the \$2,130 per person that was received in 1995-96².

2.166 To compensate for such a reduction in federal revenue, the Province needs to generate a higher level of provincial own-source revenue. However, this type of revenue is largely dependent on the economy. For instance, about 50% of total revenue of the Province in 1996-97 took the form of taxes. When the economy is strong, more people purchase goods and services, more people buy land for homes and business, and more people or businesses are working profitably. These factors will increase consumption taxes, property taxes and income taxes.

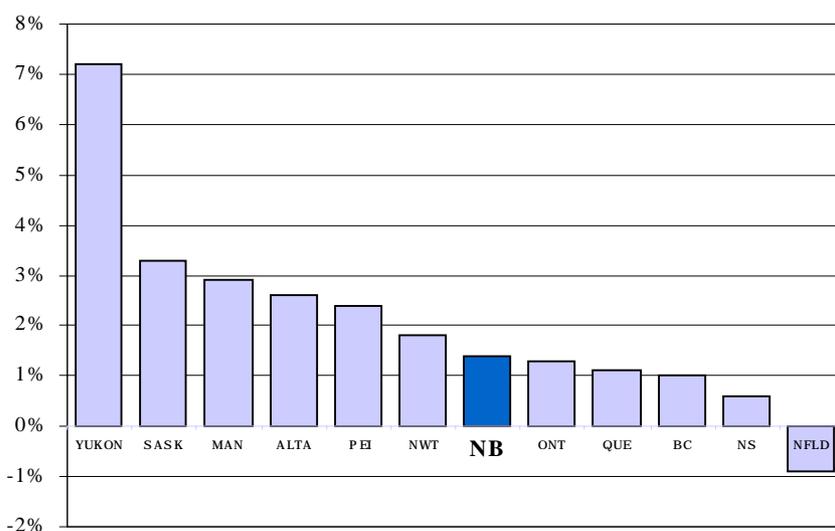
2.167 Taxes on consumption and property increased by a moderate amount in 1996-97. Taxes on income increased by \$155.4 million or 17%. This was \$125.7 million more than predicted by the Minister of Finance's Main Estimates. This large increase is due, in part, to the settlement of outstanding claims by certain corporate taxpayers.

1. Population as at 31 March 1997 per N.B. Statistics Agency.

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

2.168 In New Brunswick, combined taxes¹ per person totalled \$2,994 in 1996-97². This is an increase from the 1995-96 level of \$2,774 per person³. An increase in combined taxes per person may reflect a slowly improving economy. One indicator of a growing economy is the Gross Domestic Product (GDP) of New Brunswick. The Minister of Finance predicted a 2.5% increase in real GDP during the 1996 calendar year⁴. Though the expected level of growth did not materialize, New Brunswick still demonstrated growth of 1.4% during that period⁵. Exhibit 2.23 compares real GDP growth in New Brunswick to growth experienced in other provinces and territories during 1996.

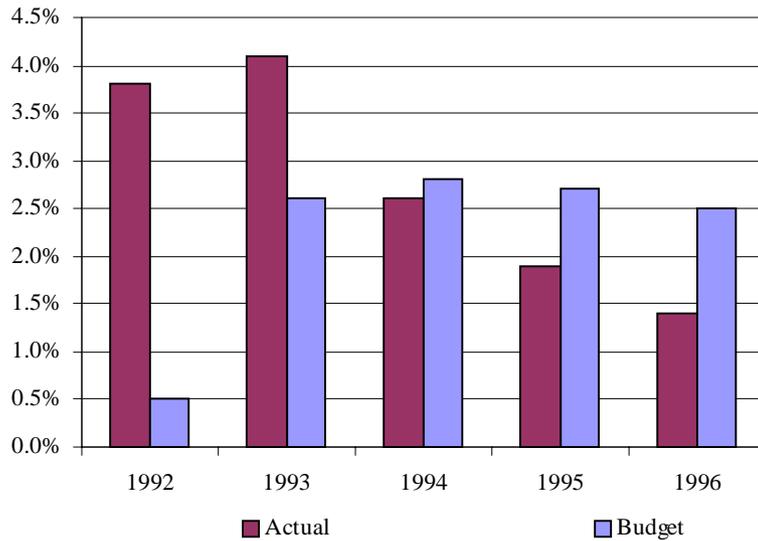
*Exhibit 2.23
Growth in the gross domestic product in real terms, by province and territory*



2.169 Exhibit 2.24 shows the growth in real gross domestic product for New Brunswick over the last five years. It also shows the percentage growth expected by the Minister of Finance as detailed by the annual budget speeches. There has been actual growth which exceeded expected growth in two of the last five years.

1. Combined taxes include consumption, property, income and other taxes as disclosed in statement of revenue and expenditure
2. Population as at 31 March 1997 per N.B. Statistics Agency.
3. Population as at 31 March 1996 per N.B. Statistics Agency.
4. Economic and Fiscal Context, 1996-97 Budget presented by Minister of Finance.
5. Gross Domestic Product at market prices, at 1986 prices per N.B. Statistics Agency

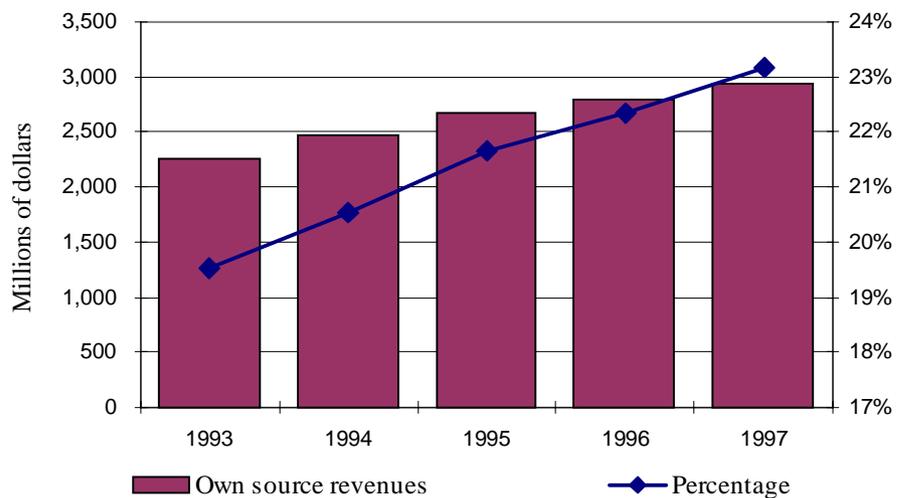
Exhibit 2.24
 Comparison of budgeted growth in real GDP to actual, by year



2.170 Where growth in the economy does not meet expectations, government may need to increase taxes or implement higher user fees. Provincial own-source revenue consists mainly of taxes and user fees from the residents and businesses in New Brunswick. As a government increases taxes and user fees, the willingness and ability of the public to tolerate such increases diminishes.

2.171 Exhibit 2.25 shows provincial own-source revenue over the last five years. It also shows the percentage of provincial own-source revenue to the gross domestic product. As the Province extracts more taxes and user fees from the economy, it becomes more challenging to encourage growth, which in turn, reduces the potential for future provincial revenue.

Exhibit 2.25
 Provincial own-source revenue and percentage of GDP, by year



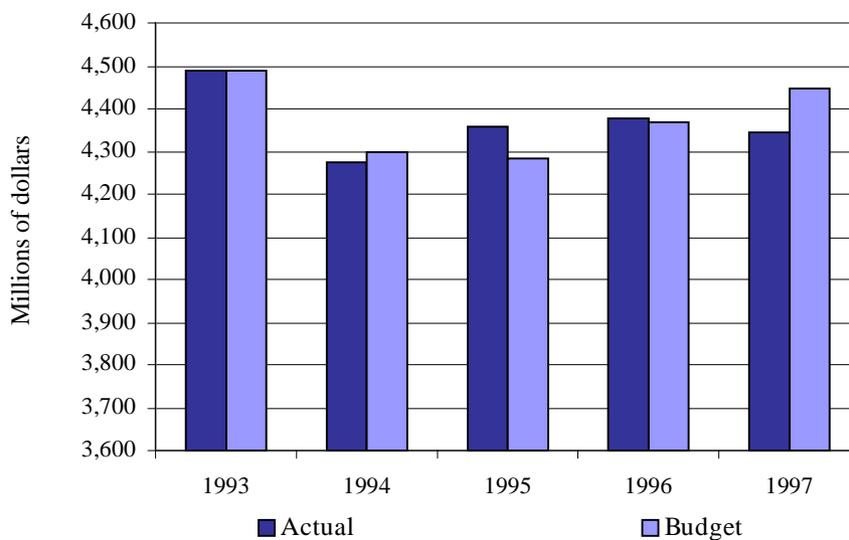
2.172 In recent years, the Province has committed to reducing its reliance on federal revenue. To become less dependent on federal revenue, the Province must inevitably resort to increasing its own-source revenue. The government has succeeded in generating sufficient own-source revenue to compensate in recent years. However, in a moderate or low growth economy there eventually comes a point at which this type of revenue cannot be increased any further.

2.173 It is at this point when the flexibility of a government to obtain money is reduced. Most funding for a government's activities comes from one of three broad categories: federal revenue, own-source revenue or borrowing. If federal funding is unavailable or uncertain and own-source revenues have been maximized, then one of the few options remaining (apart from reducing expenditure) is to finance provincial shortfalls through borrowing. It is important for the Province to maintain a level of flexibility which will prevent the need for dependence on significant, additional amounts of long-term borrowing.

Expenditure

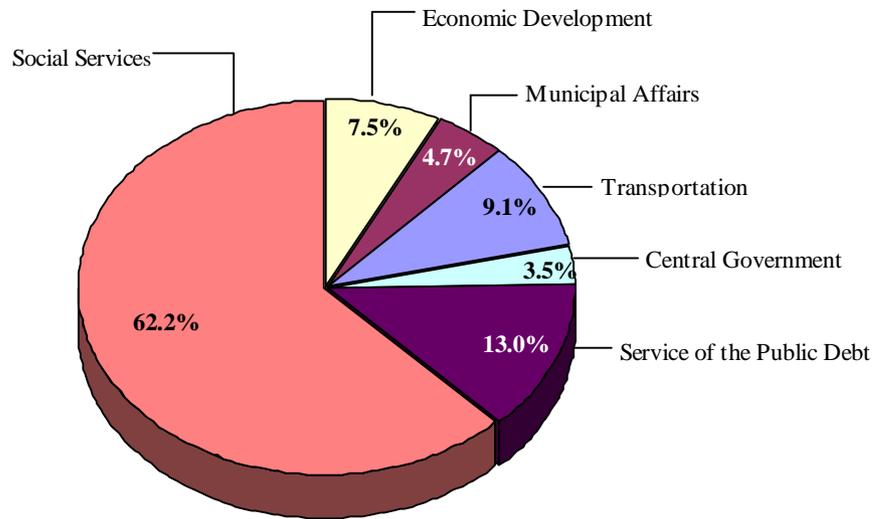
2.174 In total, 1996-97 spending decreased by \$30 million (or 0.7%) as compared to the prior year. This year's spending also came in under budget by almost \$100 million. Exhibit 2.26 demonstrates that the Province has spent less than budgeted in three of the last five fiscal years.

Exhibit 2.26
Comparison of budgeted
expenditure to actual, by year



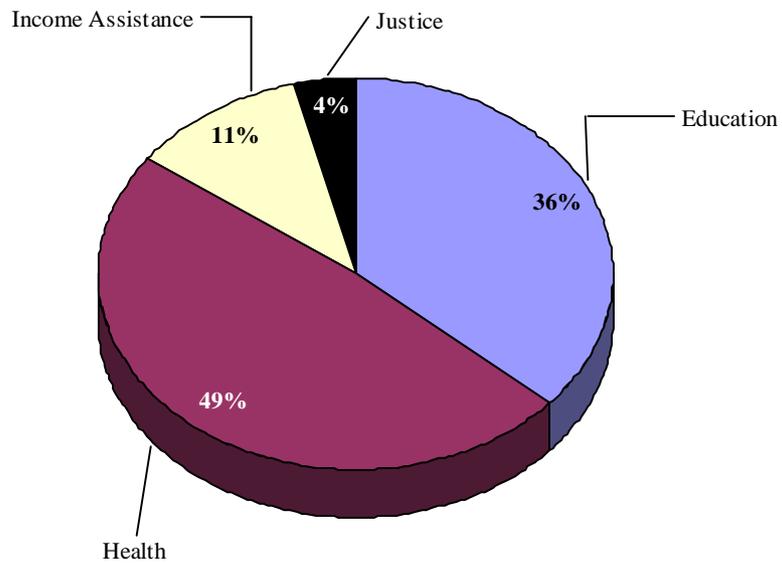
2.175 There has been public concern in recent years that spending on social services is being reduced or eliminated. Exhibit 2.27 shows that 1996-97 expenditure for social services stands at 62.2% of total expenditures. This is actually an increase from the previous year's level of 61.1%.

Exhibit 2.27
Components of total expenditure



2.176 Social services spending is further broken down into its components: Health, Income Assistance, Education and Justice.

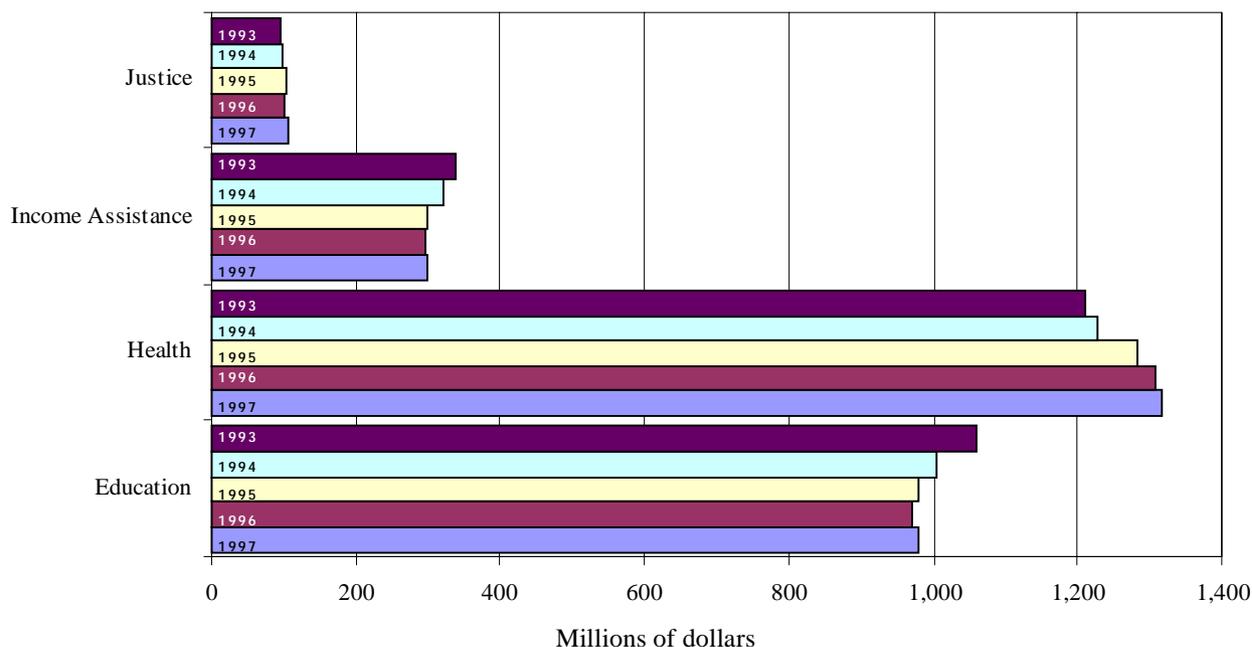
Exhibit 2.28
Components of social services spending



2.177 The largest increase in social services spending during 1996-97 was in Education. Education spending increased by \$10 million. As demonstrated by Exhibit 2.29 it is the first time in four years that spending in Education has been increased. Moderate rises in spending in justice and income assistance have also occurred in the current year.

Exhibit 2.29

Social services expenditure, by year



2.178 Spending in health has increased during each of the last four years. However, it is difficult to determine the total cost of health care using the information in the Financial Statements. Assuming hospitals and nursing homes receive the majority of their funding from the provincial government, any deficits that they may experience may eventually impact the expenditure of the Province and the cost of health care in New Brunswick.

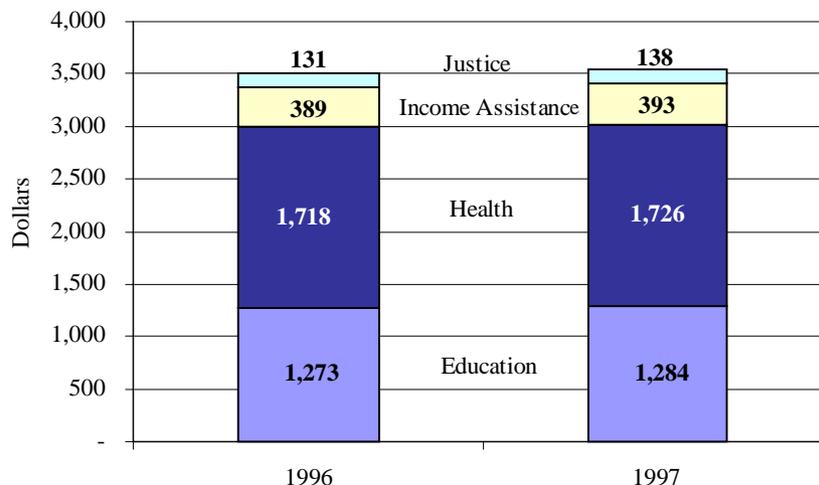
2.179 Note 1 to the Financial Statements states that hospital corporations and nursing homes are included in the financial statements using the transaction basis. This means the revenue and expenditure of these entities are not included in the balances of the Province. To improve disclosure, the provincial reporting entity has been expanded in recent years to include more detail on some major organizations that are accountable to the government. However, to get a complete picture, readers may still need to look to other financial information provided by the hospital corporations and nursing homes of the Province.

2.180 It is interesting to note that total spending by the Province for all the social services is approximately \$3,541 per person in New Brunswick¹. This is up from 1996's social services spending of \$3,511 per person in New Brunswick². Exhibit 2.30 breaks these amounts down into their component programs.

1. Population as at 31 March 1997 per N.B. Statistics Agency

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

Exhibit 2.30
 Components of total social services spending on a per capita basis



2.181 The combined spending increases in Education, Health, Income Assistance and Justice were almost completely offset by spending reductions in Transportation and Central Government. Each program reduced expenditure by approximately \$13 million in 1996-97.

2.182 The cost of servicing the public debt decreased in 1996-97 from last year's \$595 million to \$564.4 million. This is a decrease of over \$30 million. This expenditure now consumes 13% (13.6% in 1995-96) of every dollar spent. It is the second consecutive year that the cost of servicing the public debt has decreased.

2.183 This decrease seemed to be unanticipated by the Minister of Finance in his Main Estimates. Main Estimates reflect a budget for Service of the Public Debt of \$596 million. This is significantly higher than the actual results at \$564.4 million.

Summary

2.184 Exhibit 2.31 examines the Statement of Revenue and Expenditure from the perspective of a resident of the Province of New Brunswick.

Exhibit 2.31
 Revenue, expenditure and surplus per person

	Per person in New Brunswick	
	1997	1996
Federal source revenue	\$ 1,994	\$ 2,130
Own source revenue	3,867	3,679
Total revenue	5,861	5,809
Social services expenditure	3,541	3,511
Borrowing cost	740	781
Other expenditures	1,416	1,450
Total expenditure	5,697	5,742
Surplus	\$ 164	\$ 67