6 Indicators of Financial Condition

Summary

In 2009, the Public Sector Accounting Board (PSAB) issued Statement of Recommended Practices (SORP) 4: Indicators of Financial Condition. Information on financial condition is useful to users of financial statements by demonstrating how the government may be able to respond to changes in the economic climate.

The Public Accounts currently contain information on the economy but not information on how the Province is performing in that economy. That is the intent of the SORP. The SORP recommends that, at a minimum, indicators related to government's sustainability, flexibility and vulnerability to its economic climate be disclosed. Governments are not required to implement recommendations under the SORP.

The information included in this chapter is for consideration only. We feel it is important and useful to provide indicators of financial condition and, in doing so, we are following a trend in several other legislative audit offices in Canada.

The indicators we considered each demonstrate the improved financial condition of the Province, for the most part, from 2002 to 2008. One indicator, however, may best illustrate the shape of things to come. The annual surplus of the Province at March 31, 2009 is lower than at any other time this decade. This indicator demonstrates the risks facing government in maintaining the programs and services it currently provides as well as the policy and operational decisions it must make in light of its financial health.

6 Indicators of Financial Condition

Introduction

6.1 The consolidated financial statements provide a snapshot of the Province's financial position at its fiscal year end (March 31) and the results of its operations, and changes in both cash flow and net direct debt for the preceding year. However, the financial position of the Province as reflected in the consolidated financial statements is only one factor in determining the financial condition of the government. The consolidated financial statements do not provide a complete indication of the financial health of the Province nor indicate how well it is performing in relation to its economic and fiscal environment.

6.2 In 2009, PSAB issued Statement of Recommended Practices (SORP) 4: Indicators of Financial Condition. The SORP notes that *"The main objective of reporting on financial condition is to expand on and explain information in the financial statements by assessing a government's financial condition…"* This information may help financial statement users better understand, for example, the risks facing a government in maintaining the programs and services it currently provides, as well as the policy and operational decisions it must make in light of its financial health.

6.3 This SORP is not part of generally accepted accounting principals (GAAP) and there is no requirement for governments to implement its recommendations. At present, the Province includes information on the economy in the Financial Statement Discussion and Analysis included in Volume 1 of the Public Accounts. However, this information does not link the consolidated financial statements to the economic climate in which the Province operates. The purpose of this Chapter is to help provide that link through numerical and narrative analysis of several indicators.

6.4 There may be numerous indicators to assess a government's financial condition. The SORP recommends that, at a minimum, indicators related to sustainability, flexibility and vulnerability be considered. Definitions of these assessors follow, as well as a selection of indicators related to each. The SORP also recommends that indicators include those specific to government and related to government, and notes that indicators related to the economy may be useful.

6.5 We feel it is important and useful to show indicators of financial condition regardless of whether the economy is strong, as it was a few years ago, or weak, as is currently the global situation. In doing so, we are following a trend in several other legislative audit offices in Canada. We intend to expand and improve this reporting in future years.

6.6 Information on the Province's financial condition has been developed using certain indicators contained in the Statement of Recommended Practices. We note that there may be other relevant indicators which would provide additional useful information for stakeholders' assessment of financial condition. The indicators selected provide stakeholders with information which may be used to assess the ability of the government to continue offering current programs and services along with its ability to respond to changes in economic conditions. The information also demonstrates the reliance the government places on funds received from the federal government.

INDICATORS OF FINANCIAL CONDITION

Indicators

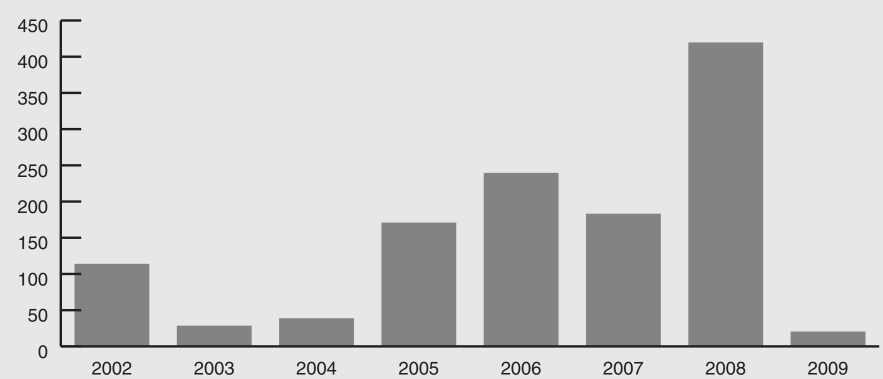
Sustainability

6.7 Sustainability measures the ability of a government to maintain its existing programs and services, including maintaining its financial obligations to creditors, without increasing its debt or raising taxes. The following indicators have been selected to assess sustainability.

Annual Surplus or Deficit

6.8 This annual result indicates the extent to which the government's revenue is more than its expenses during that year. A surplus means revenues exceed expenses while a deficit indicates that government has not lived within its means. As noted below, there are significant fluctuations in the annual surplus from 2002 to 2009 with a high of $418.9 million in 2008 to a low of $19.7 million in 2009.

Annual Surplus 2002-2009
(in $ millions)

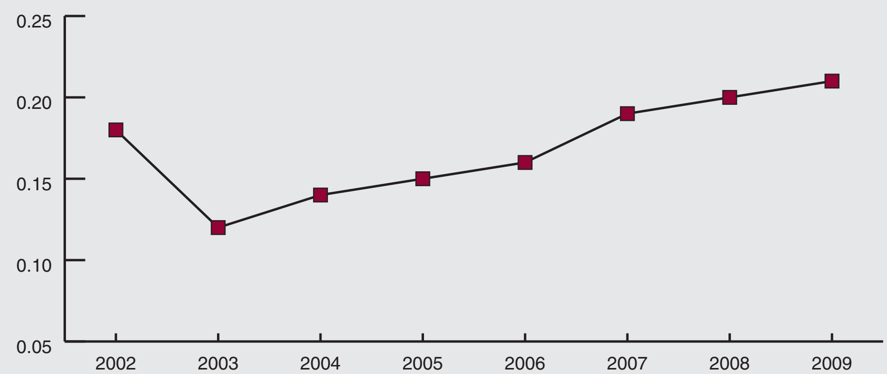


Source: Public Accounts, Volume 1

Financial Assets-to-Liabilities

6.9 This indicator shows the extent to which government's future revenues will be required to pay for past transactions or events. A ratio greater than one indicates that financial assets are sufficient to meet obligations and to finance future operations while a ratio less than one may mean a reliance on future revenues or increasing debt to pay for past decisions. The ratios since 2002 are noted below and emphasize the degree to which liabilities exceed financial assets, and the fact that significant future revenues will be required to pay for past transactions or events. It is noted, however, that the ratio has steadily improved from 0.12 in 2003 to 0.21 at March 31, 2009.

Financial Assets-to-Liabilities

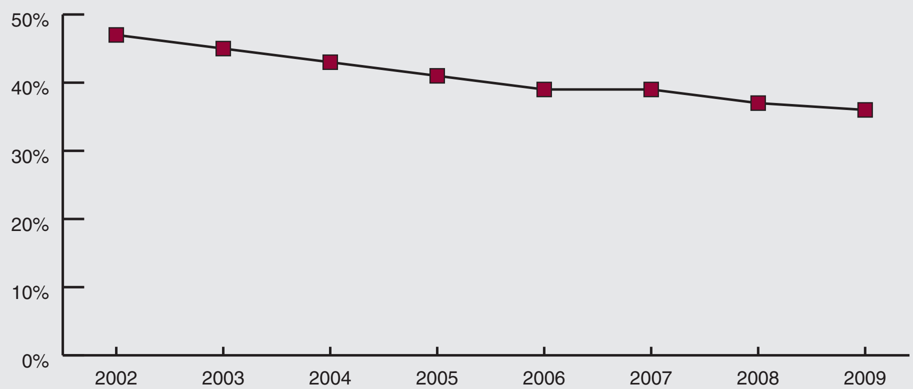


Source: Public Accounts, Volume 1

Net Direct Debt–to-Provincial GDP

6.10 This indicator demonstrates the impact government's debt may have on its economy. A high ratio may indicate that government's debt places a burden on the economy. The net direct debt increased from $12.1 billion in 2002 to $12.3 billion in 2009; however, net direct debt as a percentage of provincial gross domestic product (GDP) has decreased from 47% to 36% during the same period. As this ratio declines, the net direct debt becomes less of a burden on the provincial economy.

Net Direct Debt as a Percentage of Provincial GDP



Source: Public Accounts, Volume 1; Statistics Canada

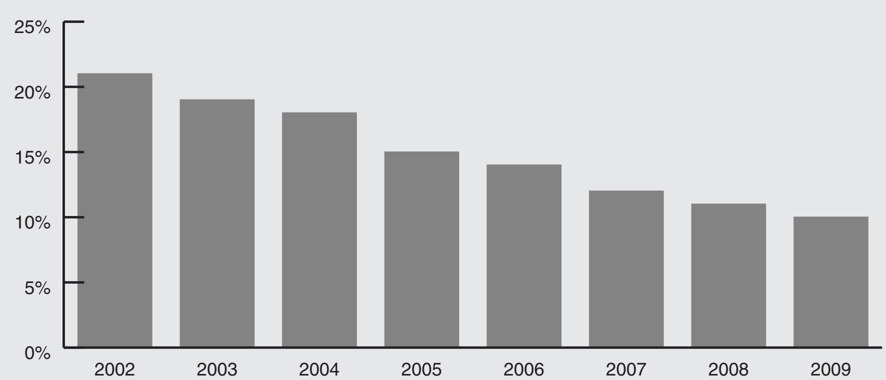
Flexibility

6.11 Flexibility describes the extent to which a government can change its debt burden or raise taxes within its economy. Increasing debt and taxation reduces flexibility and government's ability to respond to changing circumstances.

Debt Servicing Costs-to-Revenues

6.12 The ratio of debt servicing costs-to-revenues indicates the amount of current revenue that is required to service past borrowing decisions and, as a result, is not available for programs and services. As indicated below, debt servicing costs were 21% of revenue in 2001-02 and steadily decreased over the years to 10% at March 31, 2009.

Debt Servicing Costs as a Percentage of Revenue



Source: Public Accounts, Volume 1

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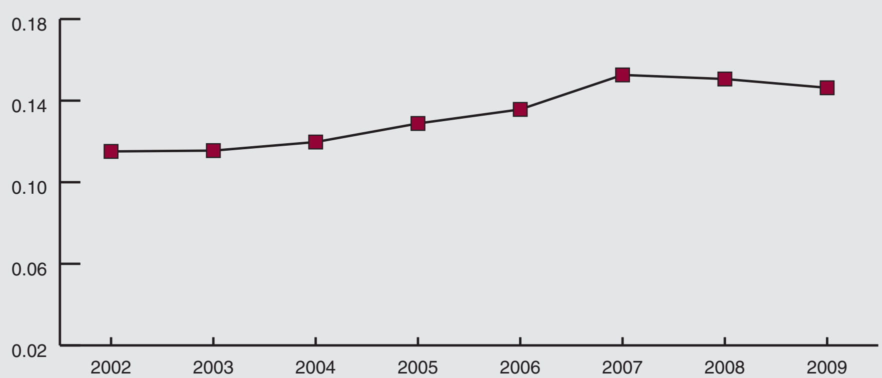
Own-Source Revenue-to-Provincial GDP

6.13 Own-source revenue-to-provincial GDP is an indictor of government revenue derived from the provincial economy, through taxation or other sources, compared to the provincial GDP. Increasing ratios may indicate a reduction in flexibility; however, the impact on flexibility would be affected by taxpayers' willingness for government to increase taxation or other own-source revenue. Tax rates and other own-source revenue that are currently high may also impact the government's ability to increase own-source revenue and may have a negative impact on flexibility. As noted in the following chart, the ratio increased from 0.115 in 2001-02 to 0.153 in 2006-07, declining to 0.146 in 2008-09.

6.14 For the purpose of the following chart, own-source revenue is defined as provincial source revenue, including prior years' adjustments, as noted in the Public Accounts.

Ratio of Own-Source Revenue-to-Provincial GDP



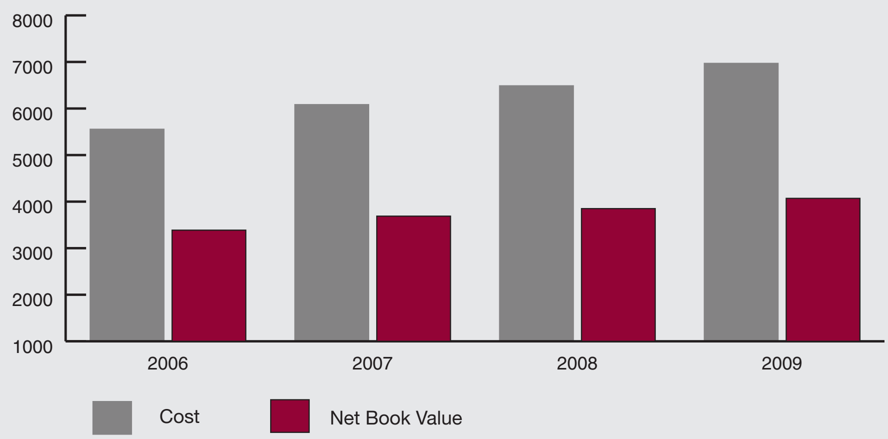
Source: Public Accounts, Volume 1; Statistics Canada

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

6.15 According to SORP 4, net book value of tangible capital assets (TCA) compared to total cost of TCA measures *"...the extent to which the estimated useful lives of a government's tangible capital assets are available to provide its products and services"*.

6.16 SORP 4 indicates that at least five years worth of data should be used. Due to the retroactive change in an accounting policy, required data is not available prior to 2005-06; therefore, only four years of data are presented in the following table. The ratio in 2005-06 was 0.61, declining to 0.58 in 2008-09. A diminishing ratio may indicate increasing deferred replacement or maintenance costs; however, due to the limited number of years of available data, one must be cautious in drawing conclusions on the significance of the decline. The net book value increased from 2005-06 through to 2008-09 which indicates that the rate of investment in TCA was greater than TCA amortization and disposals.

Net Book Value of Tangible Capital Assets-to-Cost of Tangible Capital Assets (in $millions)



Source: Public Accounts, Volume 1

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Vulnerability

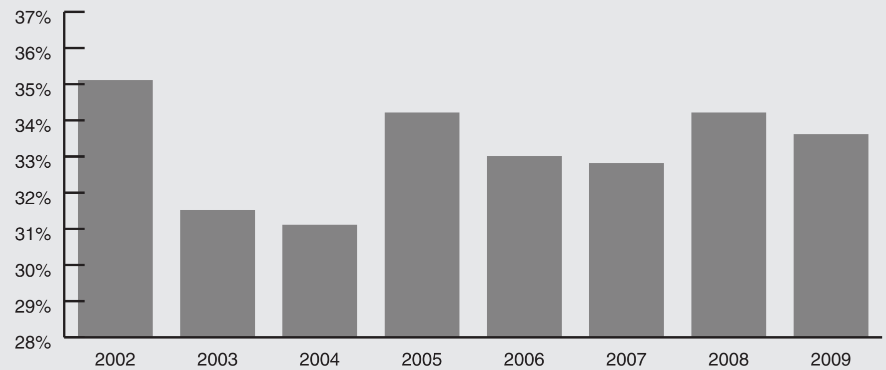
6.17 Vulnerability indicators can measure the amount government is dependent on sources of revenue outside its control and its exposure to risks which might affect the government's ability to meet its commitments. The lower government's own-source revenue is, the more it relies on fiscal decisions of others.

Federal Government Transfers-to-Total Revenues

6.18 This indicator demonstrates the level of federal government transfers compared to total government revenues. The higher the percentage, the more reliance the provincial government puts on receipt of funds from the federal government. These transfers are dependent on policy decisions at the federal level and outside the control of the provincial government. As noted in the following exhibit, federal transfers as a percentage of total revenue for the province can vary significantly from year to year. Since 2002, the percentage has been at a high of 35.1% to a low of 31.1%. For the year end March 31, 2009, the revenue received from the federal government was 33.6% of total provincial revenue.

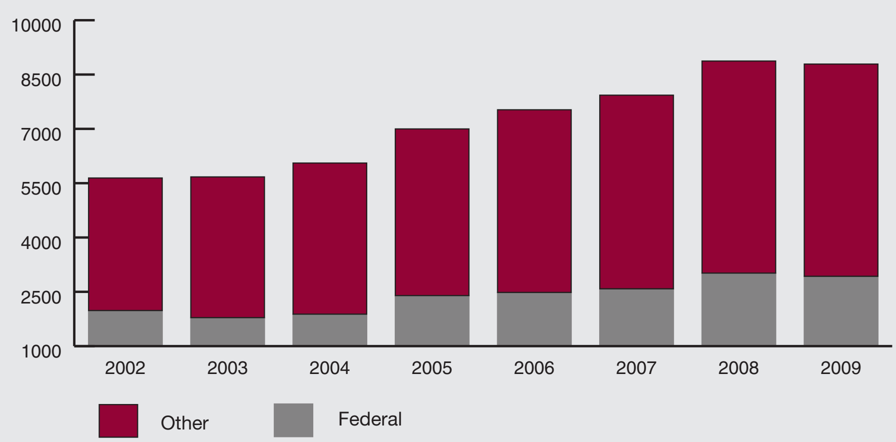
6.19 For purposes of the following two exhibits, revenues for 2005-06 through to 2008-09 were adjusted from the figures in the Public Accounts to exclude TCA cost-shared revenue which was netted against the cost of assets in years prior to 2005-06.

Federal Revenue as a Percentage of Total Revenue



Source: Public Accounts, Volume 1

Federal Revenue-to-Total Revenue
(in $ millions)



Source: Public Accounts, Volume 1