6 Indicators of Financial Condition

Summary

In the February 2010 Report of the Auditor General, we presented information on certain financial indicators for the Province of Nova Scotia for the first time. In this report, we have expanded our presentation by including comparative information on these indicators from five similar jurisdictions. The information in this Chapter is for consideration only.

Information on financial condition is helpful to users of financial statements because it demonstrates how the government may be able to respond to changes in the economic climate. The usefulness of this information is supported by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). In 2009, PSAB issued Statement of Recommended Practices (SORP) 4: Indicators of Financial Condition.

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 indicators we considered each demonstrate the financial condition of the Province. Most indicators present results from 2006 to 2010. This timeframe is shorter than that included in our February 2010 Report in order to easily present comparative information.

One indicator may best illustrate the challenges facing the Province. The annual operating results have been presented for nine years. The deficit of $329.6 million (restated) for the year ended March 31, 2010 is the first deficit of 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

INDICATORS OF FINANCIAL CONDITION

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 its 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 principles (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 recovering from a downturn, as is currently the global situation. In doing so, we are following a trend in several other legislative audit offices in Canada.

6.6 In 2009, we committed to expand and improve this reporting for future years. In order to present how Nova Scotia compares to other provinces, we have expanded our report to include five additional provinces: New Brunswick, Newfoundland and Labrador, and Prince Edward Island because they operate in the same regional economic environment; and Saskatchewan and Manitoba because they are comparable in population. The information in the following exhibits has been taken from these jurisdictions' public accounts from 2006 to 2010, with the exception of Prince Edward Island, and Newfoundland and Labrador, neither of which has yet released public accounts for the year ended March 31, 2010.

6.7 As noted in Chapter 5 (see paragraph 5.33), an error totalling $87.7 million was discovered in the March 31, 2010 financial statements subsequent to their release. This error impacts several amounts on the financial statements and will be corrected on the March 31, 2011 financial statements. Throughout this chapter, we will reference certain amounts from the March 31, 2010 financial statements, adjusting for the error. Details of restated amounts are noted below.

	Amount per Public Accounts ($ thousands)	Increase (Decrease) ($ thousands)	Restated Amount ($ thousands)
Statement of Financial Position			
Accounts Receivable and Advances	938,404	(87,721)	850,683
Total Financial Assets	3,478,961	(87,721)	3,391,240
Net Direct Debt	(13,018,556)	87,721	(13,106,277)
Accumulated Deficits	(8,402,784)	87,721	(8,490,505)
Statement of Operations			
Revenue Provincial Sources	4,849,920	(73,994)	4,775,926
Revenue Prior Year's Adjustment	48,234	(13,727)	34,507
Total Revenue	8,910,934	(87,721)	8,823,213
Deficit from Government Units	(600,655)	87,721	(688,376)
Provincial Deficit	(241,924)	87,721	(329,645)

6.8 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

INDICATORS OF FINANCIAL CONDITION

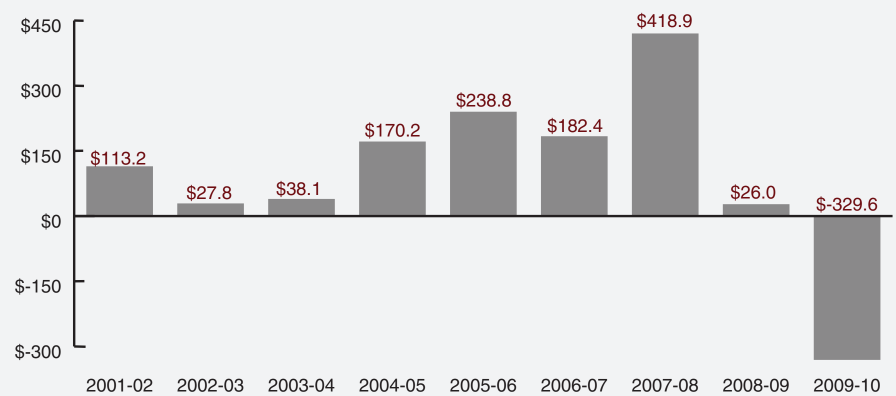
Sustainability

6.9 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

6.10 This annual result indicates the extent to which the government's revenues are 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. In Nova Scotia, a deficit also means government has to increase its debt in order to finance its operations. As noted below, there are significant fluctuations in the annual results of the Province from 2002 to 2010, ranging from a surplus of $418.9 million in 2008 to a deficit of $329.6 million in 2010.

Nova Scotia Annual Surplus or Deficit
(in millions)

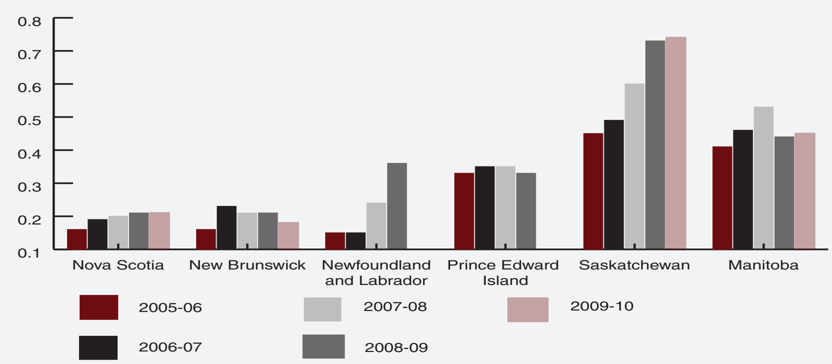


Source 1 (see end of chapter)

Financial Assets-to-Liabilities Ratio

6.11 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 2006 are noted below and emphasize the degree to which liabilities exceed financial assets. It is noted, however, that the ratio for Nova Scotia has improved from 0.16 in 2006 to 0.21 at March 31, 2010, although it is significantly lower than most comparable jurisdictions.

Financial Assets-to-Liabilities Ratio

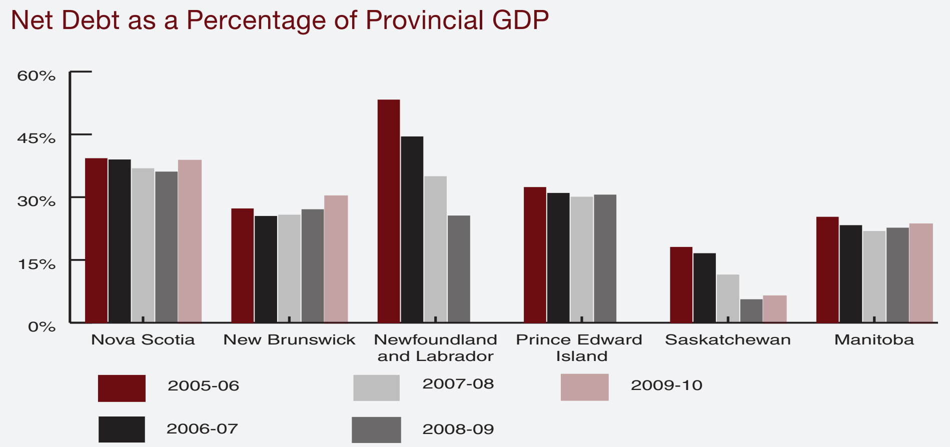


Sources 1, 2, 3 (see end of chapter)

Financial Assets-to-Liabilities Ratio for Nova Scotia			
Year Ending March 31	Financial Assets ($ millions)	Liabilities ($ millions)	Financial Assets/ Liabilities
2006	$2,355.7	$14,594.9	0.16
2007	$2,865.7	$15,222.9	0.19
2008	$2,962.2	$15,077.0	0.20
2009	$3,235.6	$15,553.8	0.21
2010	$3,391.2	$16,497.5	0.21

Net Debt as a Percentage of Provincial GDP

6.12 This indicator demonstrates the impact a government's debt may have on its economy. A higher percentage may indicate that government's debt places a burden on the economy. Nova Scotia's net direct debt increased from $12.2 billion in 2006 to $13.1 billion in 2010, while net direct debt as a percentage of provincial gross domestic product (GDP) declined in 2008 and 2009 before increasing to 38.7% in 2010. This ratio has not fluctuated significantly over the past five years in four of the six jurisdictions in the following exhibit although Nova Scotia's ratio has consistently been the highest among these four.



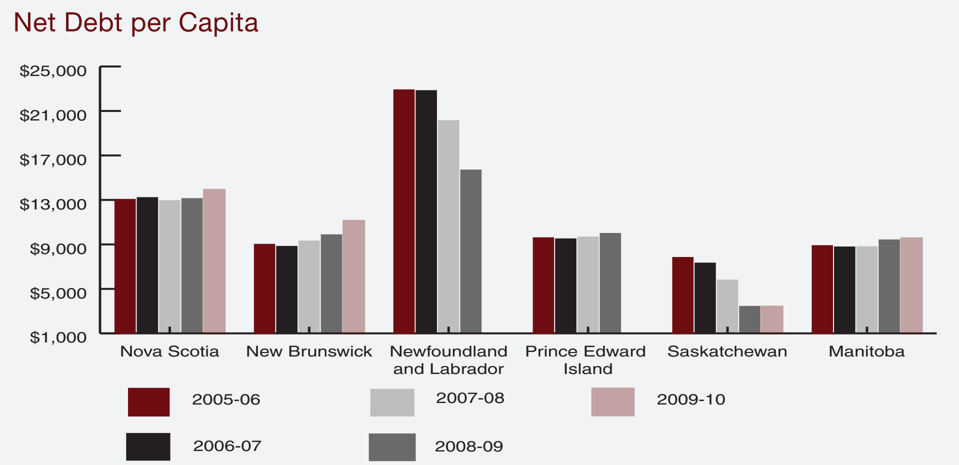
Sources 1, 2, 3, 4 (see end of chapter)

Net Debt as a Percentage of Provincial GDP for Nova Scotia			
Year Ending March 31	Net Debt ($ millions)	Provincial GDP ($ millions)	Net Debt as a % of GDP
2006	$12,239.2	$31,199	39.2%
2007	$12,357.2	$31,743	38.9%
2008	$12,114.8	$32,933	36.8%
2009	$12,318.2	$34,188	36.0%
2010	$13,106.3	$33,831	38.7%

Net Debt per Capita

6.13 This indicator provides an approximation of the net debt attributable to each resident of Nova Scotia. An increasing level of net debt per capita shows that the Province's debt is increasing at a rate exceeding population growth. Net debt per capita has been relatively stable from 2006 to 2010 with a 5 year average of $13,242 per resident and of high of $13,906 in 2010.

6.14 Nova Scotia currently has the second-highest net debt per capita among the provinces compared in the following exhibit. Net debt per capita has declined significantly in the past two years in both Newfoundland and Labrador, and Saskatchewan, which are resource-rich provinces.



Sources 1, 2, 3, 5 (see end of chapter)

Net Debt per Capita for Nova Scotia			
Year Ending March 31	Net Debt ($ millions)	Population (thousands)	Net Debt per Capita ($)
2006	$12,239.2	938.0	$13,048
2007	$12,357.2	935.8	$13,205
2008	$12,114.8	936.7	$12,933
2009	$12,318.2	939.1	$13,117
2010	$13,106.3	942.5	$13,906

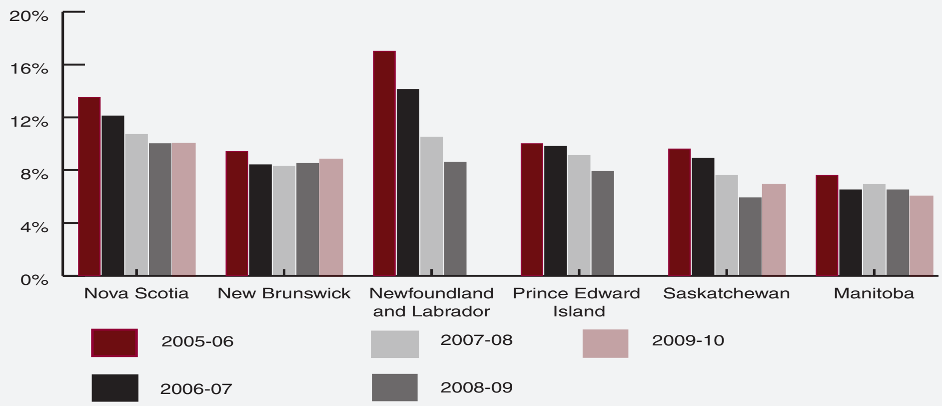
Flexibility

6.15 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. The following indicators have been selected to assess flexibility.

Debt Servicing Costs as a Percentage of Revenue

6.16 The proportion of debt servicing costs to revenue 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 13.5% of revenue in 2006 and steadily decreased to 10% at March 31, 2010. Most provinces below have experienced declining debt servicing costs over the past five years. This may result from declining interest rates as well as declining debt, and could also be attributable to increased use of derivative instruments to manage interest rate risk.

Debt Servicing Costs as a Percentage of Revenue



Sources 1, 2, 3 (see end of chapter)

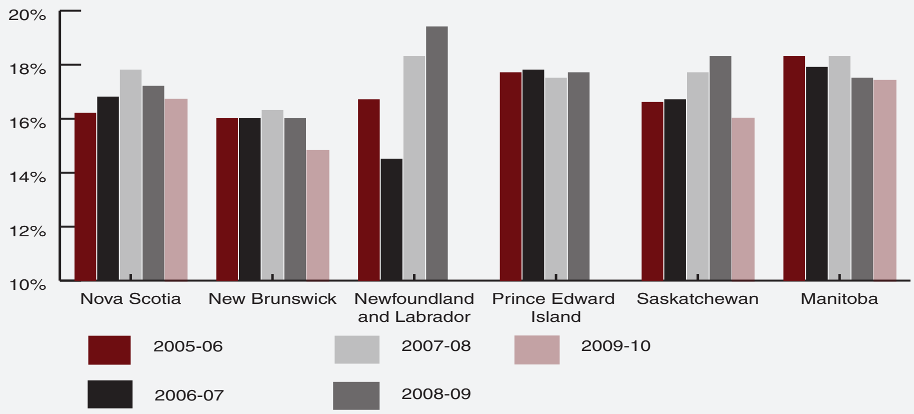
Debt Servicing Costs as a Percentage of Revenue for Nova Scotia			
Year Ending March 31	Debt Servicing Costs ($ millions)	Total Revenue ($ millions)	Debt Servicing Costs as a % of Revenue
2006	$1,017.8	$7,527.5	13.5%
2007	$958.7	$7,952.4	12.1%
2008	$953.7	$8,908.4	10.7%
2009	$887.5	$8,836.2	10.0%
2010	$880.1	$8,823.2	10.0%

Own-Source Revenue as a Percentage of Provincial GDP

6.17 Own-source revenue-to-provincial GDP is an indicator of government revenue derived from the provincial economy, through taxation or other sources, compared to the provincial GDP. Higher percentages 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.

6.18 For the purpose of the following chart, own-source revenue is defined as provincial source revenues, including prior years' adjustments, as noted in the Public Accounts (essentially, all revenue less federal transfers). Own-source revenue has remained fairly constant over the past five years in all provinces we compared, with the exception of Newfoundland and Labrador. Its increase in provincial revenues would relate to increased resource revenue.

Own-Source Revenue as a Percentage of Provincial GDP



Sources 1, 2, 3, 4 (see end of chapter)

Own-Source Revenue as a Percentage of Provincial GDP for Nova Scotia			
Year Ending March 31	Own-Source Revenue ($ millions)	Provincial GDP ($ millions)	Own-Source Revenue as a % of GDP
2006	$5,045.2	$31,199	16.2%
2007	$5,346.8	$31,743	16.8%
2008	$5,860.4	$32,933	17.8%
2009	$5,872.1	$34,188	17.2%
2010	$5,644.7	$33,831	16.7%

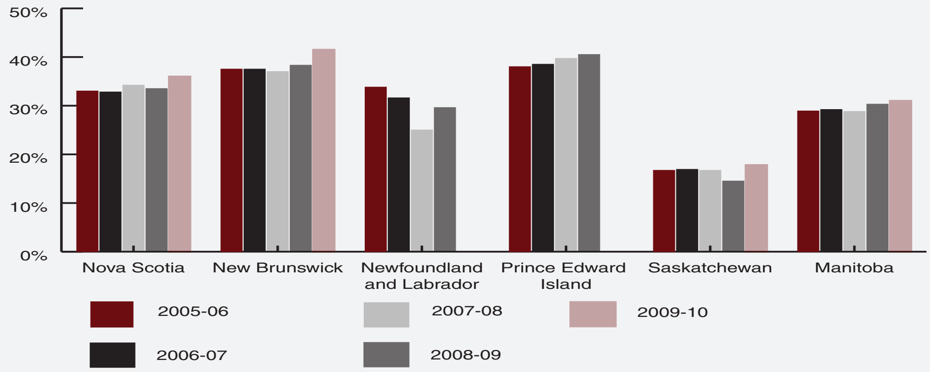
Vulnerability

6.19 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. The following indicator has been selected to assess vulnerability.

Federal Government Transfers as a Percentage of Total Revenues

6.20 This indicator demonstrates the level of federal government transfers compared to total government revenues. The higher the percentage, the more reliance the provincial government has 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 2006, the percentage has ranged from a low of 32.8% in 2007 to a high of 36% in 2010. Overall, federal transfers as a percentage of total revenues have remained constant in each jurisdiction over the past five years.

Federal Government Transfers as a Percentage of Total Revenue

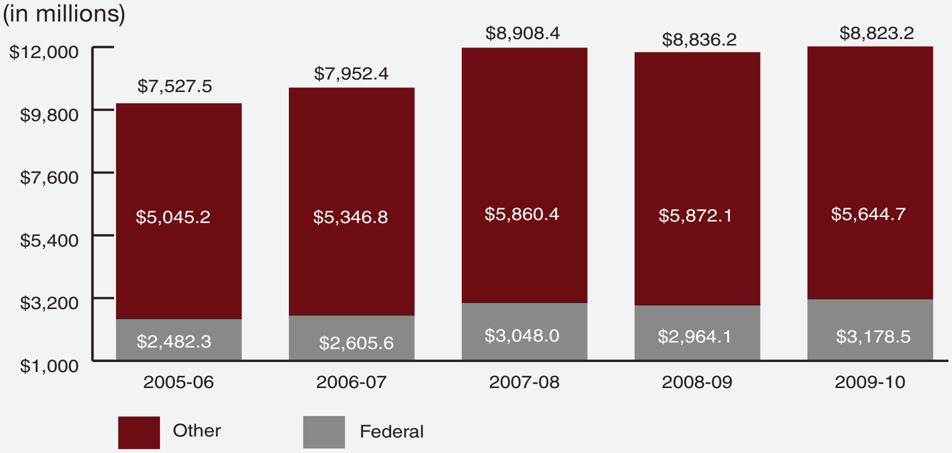


Sources 1, 2, 3 (see end of chapter)

Federal Government Transfers as a Percentage of Total Revenue for Nova Scotia			
Year Ending March 31	Federal Transfers ($ millions)	Total Revenue ($ millions)	Federal Transfers as a % of Total Revenue
2006	$2,482.3	$7,527.5	33.0%
2007	$2,605.6	$7,952.4	32.8%
2008	$3,048.0	$8,908.4	34.2%
2009	$2,964.1	$8,836.2	33.5%
2010	$3,178.5	$8,823.2	36.0%

Federal Government Transfers to Total Revenue for Nova Scotia

(in millions)



Source 1 (see end of chapter)

Sources:

(1) Nova Scotia – Public Accounts March 31, 2006 – March 31, 2010 (2010 revised for correction issued with September 22, 2010 Forecast Update)

(2) New Brunswick, Saskatchewan and Manitoba – Public Accounts March 31, 2006 – March 31, 2010

(3) Newfoundland and Labrador, Prince Edward Island – Public Accounts March 31, 2006 – March 31, 2009

(4) Statistics Canada – Gross domestic product, expenditure-based, by province and territory (2005–2008)

(5) Statistics Canada – Population by year, by province and territory (July 2006 – July 2010)