4 Indicators of Financial Condition

Summary

In recent reports, we have included information on certain indicators of sustainability, flexibility and vulnerability. This year we have focused our Report on sustainability indicators. Additional indicators can be found under the Publications tab on our website at oag-ns.ca.

We believe sustainability indicators are the most relevant in the current global climate in which high levels of sovereign debt have greatly reduced the ability of certain countries to raise and finance their debt. Sustainability indicators are a measure of government's ability to maintain existing programs and services, including maintaining obligations to creditors, without increasing debt or raising taxes.

Detailed reporting on sustainability is a recent development in government reporting. The International Public Sector Accounting Standards Board recently published an exposure draft for a recommended practice on government reporting: *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*. It recommends that government provide projections of the sources and uses of resources over a longer term, and provide commentary on the main risks impacting these projections. The reporting is meant to supplement information found in public sector financial statements and further enhance financial reporting objectives – accountability and decision-making. Several governments, including Canada, are publishing fiscal sustainability reports as part of their annual reporting package.

Volume 1 of the Public Accounts includes several indicators of government's financial position. These include five-year trends of revenues, expenses, and net debt and accumulated deficits per capita. The current Budget Assumptions and Schedules document includes a medium-term outlook (four years) for certain assumptions, and also identifies the key variables impacting revenue estimate assumptions. We encourage government to review its present reporting and consider enhanced reporting on the long-term sustainability of its programs.

4 Indicators of Financial Condition

Introduction

4.1 The province's consolidated financial statements provide a snapshot of its financial position at fiscal year end (March 31) and the results of its operations, and changes in both cash flow and net debt for the preceding fiscal year. However, the province's financial position as reflected in the consolidated financial statements is only one factor in determining the financial condition of the government. The consolidated 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.

4.2 In recent reports, this Office has provided information on certain indicators of financial condition. Several of these are included in those recommended for reporting by the Public Sector Accounting Board's *Statement of Recommended Practice 4: Indicators of Financial Condition*. The Statement is not part of generally accepted accounting principles, but is meant to provide guidance on appropriate methods for reporting supplementary information on financial condition.

4.3 The province currently provides information on the economy in the Financial Statement Discussion and Analysis, included in Volume 1 of the Public Accounts, including several indicators. However, the Financial Statement Discussion and Analysis does not include comparative indicators for other provinces and territories in Canada; this Chapter is meant to provide further information beyond what is already reported. Our report includes a comparison, where appropriate, to five other provinces; New Brunswick, Prince Edward Island and Newfoundland and Labrador because they operate in the same regional economic environment; and Manitoba and Saskatchewan because they are comparable in population. The information in this Chapter's exhibits has been taken from these jurisdictions' public accounts from 2007 to 2011 for all provinces except Newfoundland and Labrador, which has not yet released public accounts for the year ended March 31, 2011.

4.4 There may be numerous indicators to assess a government's financial condition. The Statement of Recommended Practice recommends that, at a minimum, indicators related to sustainability, flexibility and vulnerability be considered. This Chapter focuses on certain sustainability indicators. Additional indicators on sustainability, flexibility and vulnerability can be found under the Publications tab on our website at oag-ns.ca.

Indicators

Sustainability

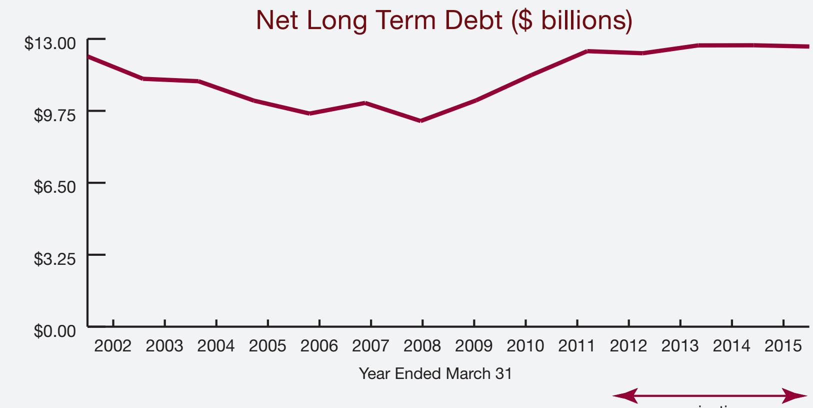
4.5 Sustainability measures the ability of a government to maintain its existing programs and services, including maintaining its obligations to creditors, without increasing its debt or raising taxes. These indicators provide insight into how a government balances its commitments and debts.

4.6 The International Public Sector Accounting Standards Board (Board) has recently published an exposure draft for a recommended practice on government reporting: *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*. The exposure draft recommends that government and public sector entities provide projections of inflows and outflows of resources over a longer term, and also provides commentary on the main risks facing these projections. The Board notes in an overview of the exposure draft that *"This information allows the users of general purpose financial reports to assess the extent to which current policies are sustainable, and complements the financial statements, which remain at the core of public sector financial reporting."*

4.7 Nova Scotia's annual budget assumptions and schedules has reflected government's four-year fiscal plan, and includes a medium-term economic outlook and projected borrowing requirements to 2014-15. Most other assumptions are forecast for one year, to March 31, 2012. In addition, key variables impacting the revenue estimates assumptions are noted, but additional information on the sensitivity of these variables would assist users in understanding the impact of economic changes on revenues. We believe government should consider additional information in its annual budget documents including longer-term projections and sensitivity of significant revenues. This would provide the House of Assembly and the public with an indication of the sustainability of government programs and services.

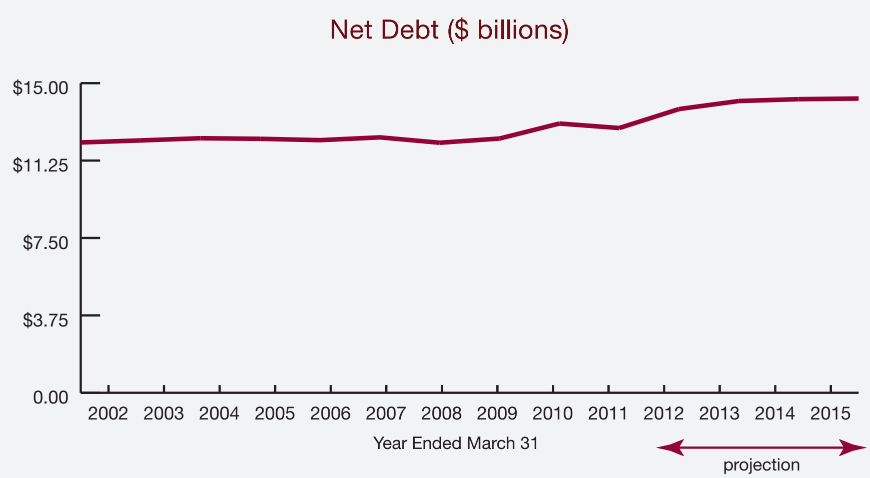
Indicators of Debt Position

4.8 *Long-term debt* – Details of the province's long-term debt is included in Schedule 4 of the March 31, 2011 Public Accounts. Gross long-term debt totalling $15.8 billion is offset by sinking fund assets of $3.4 billion resulting in a net long-term debt of $12.4 billion. The majority of this amount consists of bonds (net of sinking funds) issued by the province totalling $12.2 billion. Long-term debt is a significant indicator of fiscal sustainability in Nova Scotia.



Source: 1 and 6 (see end of chapter)

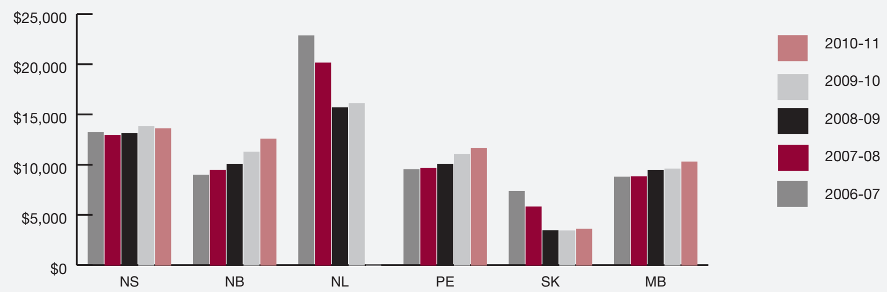
4.9 *Net debt* – Net debt is the difference between the province's financial assets and financial liabilities. It is an indication of the government's current obligations that must be funded through future revenues, including taxation. Net debt has increased by 5% or $700 million over the past ten years, although as can be seen, the increase was on an already significant net debt position of $12.1 billion at March 31, 2002. Net debt declined in 2011 because payments to universities totalling $375 million had been made in 2009-10; this reduced 2010-11 expenses. These payments will resume in 2011-12.



Source: 1 and 6 (see end of chapter)

4.10 *Net debt per capita* – Another indicator of sustainability is net debt per capita. This shows the amount of net debt attributable to each person living in a province or territory. An increasing net debt per capita shows net debt is increasing at a rate exceeding population growth, and may not be sustainable. A decreasing ratio shows that net debt is growing at a slower rate than the growth in population. The ratio in Nova Scotia has been relatively stable over the past five years ranging from a low of $12,927 in 2008 to a high of $13,841 in 2010. This is due to a population growth which approximates the growth in net debt.

Net Debt per Capita

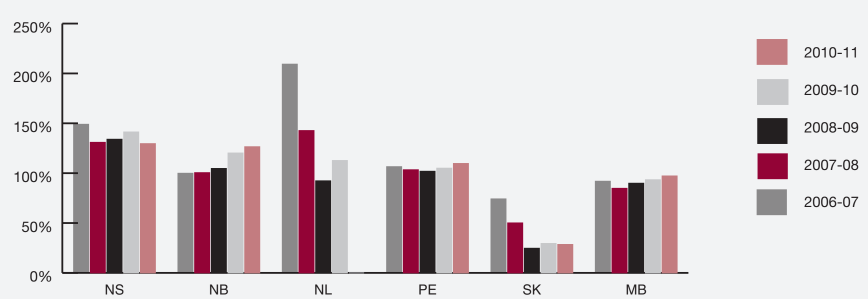


Source: 1, 2, 3 and 5 (see end of chapter)

Net Direct Debt per Capita – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Net Debt ($ thousands)	$12,357,205	$12,114,763	$12,318,239	$13,045,146	$12,827,331
Population (thousands)	935.8	937.2	940.3	944.8	945.4
Net Debt per Capita	$13,205	$12,927	$13,100	$13,807	$13,568

4.11 *Net debt as a percentage of total provincial revenues* – This indicator measures a government's net debt as a percentage of its total revenues or the amount of future revenues required to pay for past transactions. An increasing trend indicates additional time will be needed to eliminate net debt, and may not be sustainable. Over the past five years this ratio has fluctuated in Nova Scotia from a high of 149.0% in 2007 to 129.6% in 2011. Over the same time period two of our five comparative jurisdictions had significant decreases in this ratio and one jurisdiction experienced a significant increase in this ratio. The ratio for Nova Scotia has been higher than the other jurisdictions over much of this time period.

Net Debt as a Percentage of Total Provincial Revenue

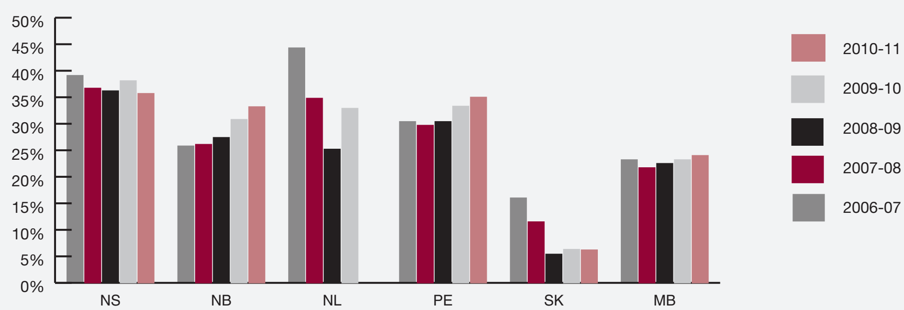


Source: 1, 2 and 3 (see end of chapter)

Net Debt as a Percentage of Total Revenue – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Net Debt ($ millions)	$12,357	$12,115	$12,318	$13,045	$12,827
Provincial Revenue ($ millions)	$8,293	$9,253	$9,196	$9,231	$9,897
Revenue/GDP	149.0%	130.9%	133.9%	141.3%	129.6%

4.12 *Net debt as a percentage of provincial GDP* – This indicator provides insight into the impact of a government's debt on its economy. A higher percentage indicates that a government's debt is becoming an increasing burden on the economy, and may not be sustainable. A stable or decreasing percentage shows the growth of net debt is equal to, or less than the growth of the economy and is likely sustainable. The following exhibit shows this ratio has fluctuated in Nova Scotia; however, the overall trend has been a declining ratio from 39.1% in 2007 to 35.7% in 2011. In the past five years two jurisdictions had significant decreases in this ratio and one jurisdiction experienced an increase in this ratio. The ratio for Nova Scotia has been higher than the other jurisdictions over much of this time period.

Net Debt as a Percentage of Provincial GDP

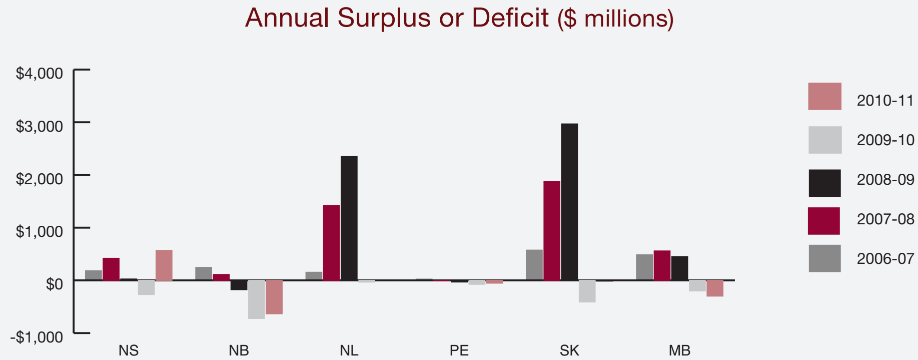


Source: 1, 2, 3 and 4 (see end of chapter)

Net Direct Debt as a Percentage of Provincial GDP – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Net Debt ($ millions)	$12,357	$12,115	$12,318	$13,045	$12,827
Provincial GDP ($ millions)	$31,644	$33,031	$34,041	$34,283	$35,952
Net Debt/GDP	39.1%	36.7%	36.2%	38.1%	35.7%

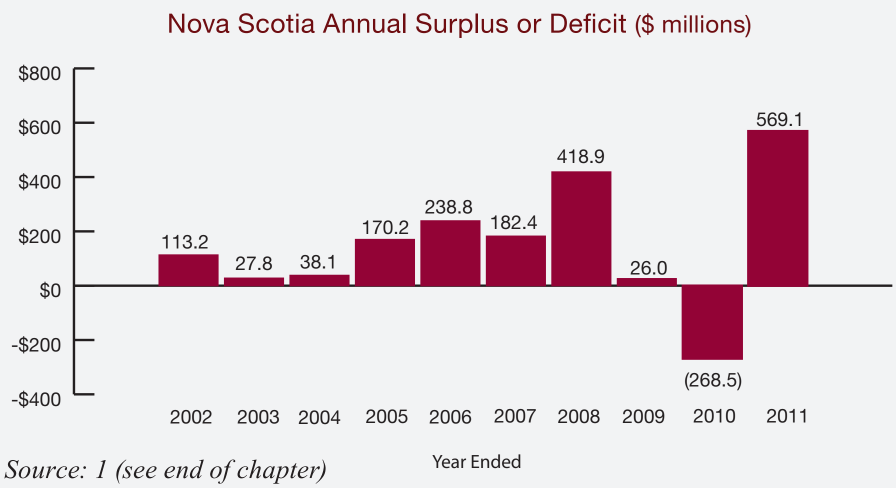
Results of Operations as Indicators of Sustainability

4.13 *Annual surplus or deficit* – This annual result indicates the extent to which the government's revenues are more or less than its expenses during the year. A surplus means revenues exceed expenses while a deficit indicates that government has not lived within its means. Recurring deficits on a long-term basis are not sustainable. As noted in the exhibit below, there have been no consistent trends in the operating results of the provinces; however, all provinces incurred deficits during the 2009-10 fiscal year.



Source: 1, 2, 3 (see end of chapter)

4.14 The Province of Nova Scotia has incurred a surplus in nine of the past ten years. There are significant fluctuations in the province's annual results from 2002 to 2011, ranging from a surplus of $569.1 million in 2011 to a deficit of $268.5 million in 2010.



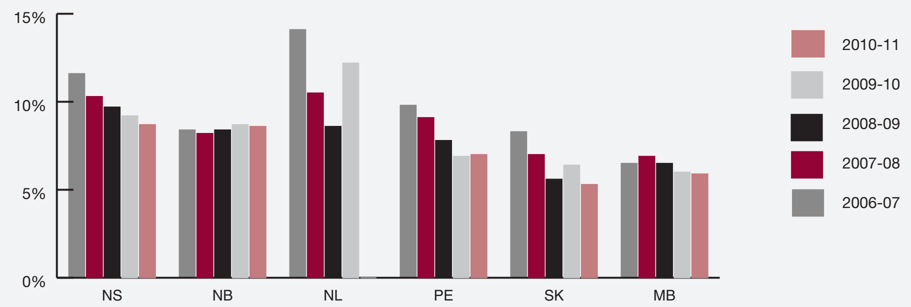
Source: 1 (see end of chapter)

Other Indicators of Sustainability

4.15 In addition to the indicators focusing on debt, information on the following indicators is also recommended for reporting under the Public Sector Accounting Board's *Statement of Recommended Practice 4: Indicators of Financial Condition*. There have been improvements in each of these indicators over the past five years. Irrespective of this, our concerns remain with the government's debt position.

4.16 *Debt servicing costs as a percentage of total revenue* – The proportion of debt servicing costs to revenue indicates the amount of current revenues that is required to service past borrowing decisions and, as a result, is not available for current and future programs and services. An increase in this ratio could reduce future flexibility, as lenders might be less likely to lend to jurisdictions with significant debt loads. In Nova Scotia this ratio has decreased from a high of 11.6% in 2007 to a low of 8.7% in 2011. The decreasing trend is consistent with three of our comparative jurisdictions. The ratio for Nova Scotia has been higher than the four other jurisdictions for most of this time period.

Debt Servicing Costs as a Percentage of Total Revenue

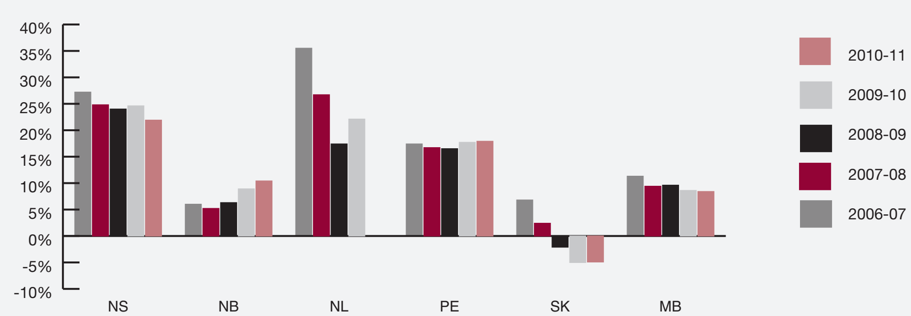


Source: 1, 2 and 3 (see end of chapter)

Debt Servicing Costs as a Percentage of Total Revenue – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Debt Servicing Costs ($ millions)	$959	$954	$887	$850	$861
Total Revenue ($ millions)	$8,293	$9,253	$9,196	$9,231	$9.897
Debt Servicing Costs as a percentage of Revenue	11.6%	10.3%	9.7%	9.2%	8.7%

4.17 *Accumulated surpluses/deficits as a percentage of provincial gross domestic product* – This indicator measures a government's accumulated surpluses/deficits as a proportion of gross domestic product (GDP). Accumulated surpluses/deficits are the sum of all surpluses and deficits incurred to date, and measure the extent to which past revenues were sufficient or insufficient to cover the cost of past transactions. An increasing ratio indicates the growth of accumulated deficit is greater than the growth of the economy, and is not likely to be sustainable. The ratio for Nova Scotia declined from 27.2% in 2007 to 21.9% in 2011 meaning that the economy grew at a faster rate than the accumulated results.

Accumulated Surpluses or Deficits as a Percentage of Provincial GDP



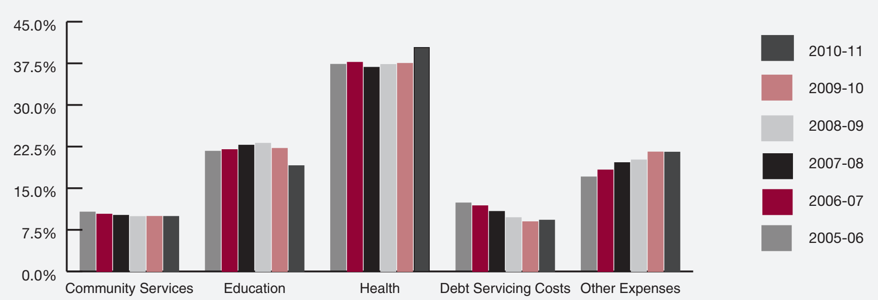
Source: 1, 2, 3 and 4 (see end of chapter)

Accumulated Deficit as a Percentage of Provincial GDP – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Accumulated Deficit ($ millions)	$8,606	$8,187	$8,161	$8,429	$7,860
Provincial GDP($ millions)	$31,644	$33,031	$34,041	$34,283	$35,952
Accumulated Deficit/GDP	27.2%	24.8%	24.0%	24.6%	21.9%

4.18 *Expenses by department as a percentage of total expenses for Nova Scotia* – This indicator shows the proportion of total expenses allocated to the various areas of government spending. An increase in the ratio in one or more areas indicates the rate of growth for these areas is increasing faster than the increase of total expenses. This trend may reduce funding available for other areas of government spending and provides indication of sustainability of all government programs. Information for this indicator is presented for Nova Scotia only as other jurisdictions allocate their expenses differently than Nova Scotia.

4.19 The following exhibit shows the six largest areas of government spending. Debt servicing costs declined as a percentage of total expenses over this five year period. The percentage of expenses allocated to health was approximately 37.3% of total expenses from 2007 to 2010; however, this percentage increased to 40.3% in 2011. In 2011, the percentage of expenses for health, education (including universities) and community services comprised 69.3% of total expenses.

Expenses by Department as a Percentage of Total Expenses for Nova Scotia



Source: 1 (see end of chapter)

Expense by Function as a Percentage of Total Expense						
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Community Services	10.69%	10.31%	10.10%	9.88%	9.91%	9.90%
Education	21.65%	21.93%	22.74%	23.08%	22.16%	19.04%
Health	37.31%	37.67%	36.77%	37.28%	37.48%	40.34%
Debt Servicing Costs	13.33%	11.82%	10.80%	9.68%	8.94%	9.23%
Other Expenses	17.02%	18.27%	19.59%	20.08%	21.51%	21.49%

Sources:

1. *Nova Scotia – Public Accounts for March 31, 2007 – March 31, 2011*
2. *New Brunswick, Prince Edward Island, Saskatchewan, Manitoba – Public Accounts March 31, 2007 – March 31, 2011*
3. *Newfoundland and Labrador – Public Accounts March 31, 2007 to March 31, 2010*
4. *Statistics Canada – Gross domestic product, expenditure-based, by province and territory (2006-2009)*
5. *Statistics Canada – Population by year, by province and territory (July 2007 – 2011)*
6. *Budget Assumptions and Schedules for the fiscal year 2011-12*

Income from Government Business Enterprises (GBE) has been included in the calculation of own source revenue, and total revenue for all provinces. These amounts were not consistently reported in our previous year's chapter due to the different methods of presentation in the financial statements of the other provinces. This change ensures that information presented is comparable among provinces and is consistent with the way in which most provinces report financial indicators. As a result, certain numbers have changed from those reported in our prior year's Chapter.