Province of New Brunswick

Independent Review of the Province's Financial Position

December 2006

Grant Thornton

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Executive Summary

Terms of Reference

On October 3, 2006 the new government for the Province of New Brunswick was sworn in. Grant Thornton LLP was engaged October 11, 2006 by the Province of New Brunswick to independently review, comment and make recommendations regarding:

1. the difference in projected revenues, spending and fiscal results to year end when compared to the 2006-07 Main Estimates; including provision for losses in loans and advances portfolios;
2. the Province's adoption of the CICA Public Sector Accounting Board (PSAB) accounting for Tangible Capital Assets and the future implications of this approach with respect to Net Debt and debt obligations;
3. an estimate of the Province's future obligations including the twinning of the Trans-Canada Highway (Longs Creek to Grand Falls);
4. the current and future impact on the Province's fiscal situation as a result of the decision to cap electric power rate increases at 8% in the current year and what would result should this cap be continued in future years;
5. the future impact of the Province's finances and ongoing relationship with NB Investment Management Corporation (NBIMC), NB Liquor Corporation (ANBL), and NB Power;
6. the Province's relationship and funding of nursing homes including any future obligations for construction and renovation projects;
7. the funding status of public sector pension plans;
8. the accounting for retirement allowances excluding pension plans;
9. the repetitive nature and cause of Regional Health Authority deficits; and
10. the repetitive nature and cause of Out of Province Hospital Payment deficits.

The objective of the review is to provide the Province with an overview of its financial position for the current fiscal year and to identify the fiscal implications of the Province's current programs and commitments for future fiscal years. This information will provide the basis from which the Province can make decisions about the introduction and management of programs to meet its fiscal and program objectives.

Nature of Review

This is an independent review, as specified by the Terms of Reference provided by the Province of New Brunswick, and is not an audit or review engagement as defined by the Handbook of the Canadian Institute of Chartered Accountants.

The independent review consisted primarily of interviews, document reviews and analyses and discussions. As such, Grant Thornton has made no attempt to assess the financial viability of any individual entity. Grant Thornton made inquiries of senior officials of the Province of New Brunswick and related entities as to the financial condition of Government and its agencies to November 30, 2006 and has relied on those discussions.

Acknowledgements

We would like to acknowledge the participation and assistance provided by representatives of the Province, New Brunswick Power, New Brunswick Investment Management Corporation, New Brunswick Liquor Corporation and the Regional Health Authorities throughout this review. Management and staff from these organizations were very helpful and thorough in providing information and in preparing analytical reports in support of the independent review.

The Deputy Minister of Finance and the Comptroller have provided written assurance that, to the best of their knowledge, all requested data and information has been provided for our consideration.

Current and Future Fiscal Position

Based on available information, the forecast fiscal results for 2006-07 are a **forecast deficit of $17.6 million** and a **forecast increase in net debt of $156.7 million**. Like all forecasts, this forecast is subject to change based on changes to assumptions. This forecast will also change based on decisions about implementation of some **$60.7 million of announced programs** and a range of other items where new information has been received or additional information is required.

Historical expenditure trends, and the implications of previous decisions about new or revised programs will create fiscal pressures for the Province beyond 2006-07. Based on available information, the Province will need to manage net expenditure pressures, excluding incremental public debt charges, in addition to current year spending, as outlined below.

	2007-08	2008-09	2009-10
Net expenditure pressures compared to 2006-07	**$300 to $416 million**	**$548 to $719million**	**$573 to $773 million**

Given these net expenditure pressures, the Province will need to address fiscal pressures related to:

- the increasing investment in assets that resulted from capital acquisitions and future commitments for new highway projects;
- potential deficits at NB Power resulting from the decision to cap the 2006-07 domestic power rate increases at 8% may result in tax payers funding NB Power costs along with the possibility that NB Power could cease to be considered self-sustaining;
- the increasing financial reliance of nursing homes on Provincial funding;
- changes to pension plan costs and funding requirements primarily influenced by economic and demographic changes as well as the need to meet legislated special payment requirements when certain pension plans are not fully funded;
- the recurring deficits for Regional Health Authorities and for Out of Province Hospital Payments; and
- constrained increases in tax and other revenues.

Net Debt

The change to Tangible Capital Asset accounting since 2004 results in spreading the costs of major investments in infrastructure (such as highways and buildings) over the useful life of the asset but the impact on Net Debt continues to be reflected in the year the province constructs or acquires the asset.

It should be noted the Province must plan for the pending impact on Net Debt of large projects such as the twinning of the Trans-Canada Highway including Longs Creek to Grand Falls ($409 million in 2007-08); projects under the Canada-New Brunswick Highway Improvement agreement (provincial share of $200 million from 2007 – 2017); and large capital projects currently under construction by the Department of Supply and Services ($218 million from 2006 – 2009).

Under the former accounting policy, where the annual surplus or deficit of the Province was essentially equivalent to the change in net debt, the Province's financial performance was primarily discussed in terms of its surplus or deficit. Because the new accounting policy for Tangible Capital Assets creates a difference between the surplus or deficit and the change in net debt, it is now important to consider both measures in assessing the financial performance of the Province.

Forecast for 2006-07

The Main Estimates tabled on March 28, 2006 included a planned surplus of **$22.2** million and an increase in net debt of **$87.0** million. This planned surplus was significantly less than the actual surplus of **$243.7** million realized in 2005-06.

Based on actual expenditures and revenues to date, decisions taken subsequent to the approval of the Main Estimates and projections about expenditures and revenues to March 31, 2007, before considering risks and uncertainties, the Province is forecasting a deficit of **$17.6** million and an increase in net debt of **$156.7** million.

Table 1 – Summary of Estimates and Forecast Fiscal Results

(in millions of dollars)

	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Surplus (Deficit)	**$ 22.2**	**$ (17.6)**	**$ (39.8)**
Adjustments for Tangible Capital Assets	$ (109.2)	$ (139.1)	$ (29.9)
(Increase) Decrease in Net Debt	**$ (87.0)**	**$ (156.7)**	**$ (69.7)**

Financial forecasts are based on assumptions about future events and circumstances and actual events and circumstances may vary from these assumptions. As a result, the actual fiscal results and financial position of the Province at March 31, 2007 may vary from the forecast position shown here.

In addition, there are two significant sources of uncertainty related to the 2006-07 forecast which could cause the forecast deficit to change:

- approximately **$60.7** million in costs associated with Government program announcements where the programs have not yet been formally introduced; and
- uncertainty related to new information received since the forecast was prepared.

Government Announcements

The following new programs or changes to existing programs have been announced, but formal decisions about the introduction of these programs have not yet been made or are in progress. Should these new programs be introduced in the current fiscal year, costs associated with these programs could have a further impact on the fiscal results for 2006-07. The total estimated cost of these announced programs outlined below is **$60.7** million.

MacKay Report	$7.5m
Energy Efficiency Rebates	$20.0m
Saint John Harbour Clean Up	$29.3m
Saint John to Digby Ferry	$2.0m
Inquiry into Orimulsion	$1.0m
Student Loans – eligibility changes	No estimate known at this time
Debt Servicing Costs associated with the announced programs	$0.9m

New Information

Since the forecast for 2006-07 was prepared in October, 2006, new information has been received or additional information is required related to the following items.

Expired Collective Agreements – four expired collective agreements remain outstanding.

Federal Trust Funds – there is $68.9 million in Federal Trust funds that the Province can draw down based on the introduction of programs or initiatives within the parameters of these trust funds. It is anticipated that any new program costs would be off-set by revenues from the Federal Trust funds.

Provisions for Student Loans - as of September 30, 2006 there were $35 million in default student loans and since then, the total defaulted accounts balance has been growing by approximately $840,000 per month. As a result, the loan provision of $12.4 million for 2006-07 may need to be adjusted.

Department of Education Receivables – there are accounts receivable of $33 million against which a $22.5 million provision has been made. The adequacy of this provision may need to be adjusted.

Pension Plan deficiencies in Nursing Homes – recent actuarial reviews have identified funding deficiencies for three nursing home pension plans which the Superintendent of Pensions has ordered to be addressed. The nursing homes are appealing the order. The Province is not legally liable for these, however, given the reliance of nursing homes on funding from the Province, this could have an impact on the Province's fiscal position.

Nursing Home funding policies – the Province's introduction of the announced increases in the comfort and clothing allowance could result in $3.8 million of additional costs.

Outbreak of Pandemic Flu – while measures have been taken to prepare for a potential outbreak, if such an outbreak were to occur, it could have fiscal implications for the Province.

Pension Valuations – there are actuarial valuations outstanding for certain provincial pension plans, the results of which could impact the fiscal results of the Province.

Retirement Allowance Benefits – a recent actuarial valuation identified an $80 million increase in the estimated liability related to the retirement allowance benefits program. The impact on the fiscal results for 2006-07 will depend on the accounting treatment adopted for this new estimate.

Fiscal Responsibility and Balanced Budget Act

The Fiscal Responsibility and Balanced Budget Act indicates that it is the objective of the government that total expenses not exceed total revenues for the period commencing April 1, 2004 and ending March 31, 2007. The forecast cumulative surplus since April 1, 2004, before considering risks and uncertainties, is **$464.8 million.** The Province will therefore remain in compliance with the Fiscal Responsibility and Balanced Budget legislation unless changes to the forecast exceed this amount.

Table 2 – Cumulative Surplus

(in millions of dollars)

	Actual 2004-05	Actual 2005-06	Forecast 2006-07
Surplus (Deficit)	$ 242.2	$ 240.2	$ (17.6)
Cumulative Surplus - Beginning of the Year	$ -	$ 242.2	$ 482.4
Cumulative Surplus - End of the Year	**$ 242.2**	**$ 482.4**	**$ 464.8**

The Fiscal Responsibility and Balanced Budget Act also indicates that it is the objective of the government that, at the end of each fiscal period, the ratio of net debt to GDP will be less than at the end of the previous fiscal period.

Given the forecasted **$156.7** increase in net debt, it is important for the Province to consider the forecast ratio of net debt to GDP for 2006-07 to ensure compliance with the legislation.

Implications beyond 2006-07

The fiscal results and financial position of the Province beyond 2006-07 will be determined primarily by historical expenditure trends and previous decisions about programs and services. The resulting net expenditure pressures, over and above the current year forecast, are shown below. These amounts do not include incremental public debt charges related to funding these net expenditure pressures.

Table 3 – Net Expenditure Pressures Compared to 2006-07
(in millions of dollars)

	2007-08	*2008-09*	*2009-10*
Hospital Services costs typically increase by 7-10% annually	$70 - $100	$145 - $210	$230 - $341
Medicare costs have been growing in New Brunswick at an average of 8.8% per year	$30 - $40	$65 - $85	$100 - $130
Prescription drugs spending has grown nationally at between 10% and 11%	$14 - $15	$29 - $32	$46 - $51
Family and Community Services Program costs excluding policy changes increase at 1.5% annually	$12 - $13	$24 - $27	$37 - $41
Wage increases have typically been $40-$50 million annually	$40 - $50	$80 - $100	$120 - $150
Estimated tax revenue growth before tax reductions	($80 - $90)	($180-$210)	($300-$330)
Estimated value of announced tax reductions	$80 - $90	$100 - $110	$140 - $150
Changes to Federal Equalization Formula will also result in minimal revenue growth	-	($30 - $50)	($60 - $100)
Anticipated reductions to Federal Conditional Grants	$30 - $35	$45 - $50	$60 - $65
Reinstatement of Grant to Maritime Provinces Higher Education Commission	$60	$60	$60
Amortization of the $409 million section of the Trans-Canada Highway	$8 - $9	$8 - $9	$8 - $9
The impact of the 8% rate increase cap for NB Power could cause an annual loss	$0 - $46	$0 - $46	$0 - $46
Acquisition of alternate sources of power during the Point Lepreau shut down	-	$140 - $180	$70 - $90
Funding policy changes for nursing homes will result in incremental costs	$30 - $40	$50 - $55	$50 - $55
Funding for nursing homes construction projects will result in incremental costs	$6 - $8	$12 - $15	$12 - $15
Total Net Expenditure Pressure	**$300 - $416**	**$548 - $719**	**$573 - $773**

Other Fiscal Pressures

In addition to the net expenditure pressures described above, the Province will need to manage the following fiscal pressures going forward.

Tangible Capital Asset Accounting

Since the Province began capitalizing its asset acquisitions in 2004, the Province's tangible capital asset acquisitions have exceeded amortization expenses by **$340.8 million**. This has resulted in incremental amortization expenses of **$6 million to $8 million.**

In addition:

- the Province will acquire a **$409 million** new section of the Trans-Canada Highway (Longs Creek to Grand Falls) on November 1, 2007;
- on October 2, 2006 the Province entered into a Memorandum of Understanding with the Federal Government to cost-share in an additional **$400 million (provincial share $200 million)** of highway construction; and
- the Department of Supply and Services is currently managing capital projects totalling approximately $218 million on behalf of various government departments.

This growing asset base reduces the Province's flexibility to make annual decisions about the allocation of fiscal resources.

Cap on NB Power's Domestic Rate Increase

The decision to cap domestic rate increases to 8% may have created a deficit where future domestic power rates will not cover NB Power's cost structure. If this were to result in NB Power incurring a loss, this loss would accrue to the Province through New Brunswick Electric Finance Corporation, essentially resulting in tax payers, rather than rate payers, funding NB Power's costs.

Over the long term, if NB Power were not able to cover its operating and debt financing costs as a result of a structural deficit, it may no longer be considered a self-sustaining entity. If this were the case, the assets and debt of NB Power would need to be consolidated onto the Province's financial statements, increasing the Province's net debt.

Increasing funding for Nursing Homes

Approximately half of the province's 62 nursing homes have accumulated operating deficits.

Recent changes to nursing home funding polices and the approval of 12 capital projects will increase the proportion of funding that nursing homes receive from the Province from 65% to 85%. While nursing homes are not currently a Provincial responsibility, this increasing reliance on Provincial funding could result in a change in the Province's accounting treatment for nursing homes such that the Province would need to recognize the assets and liabilities of nursing homes on its financial statements.

Trends related to Pension Valuations

Trends such as increased life expectancy, lower discount rates, and early retirements along with changes to current pension plans could increase the Province's liabilities related to pension plans.

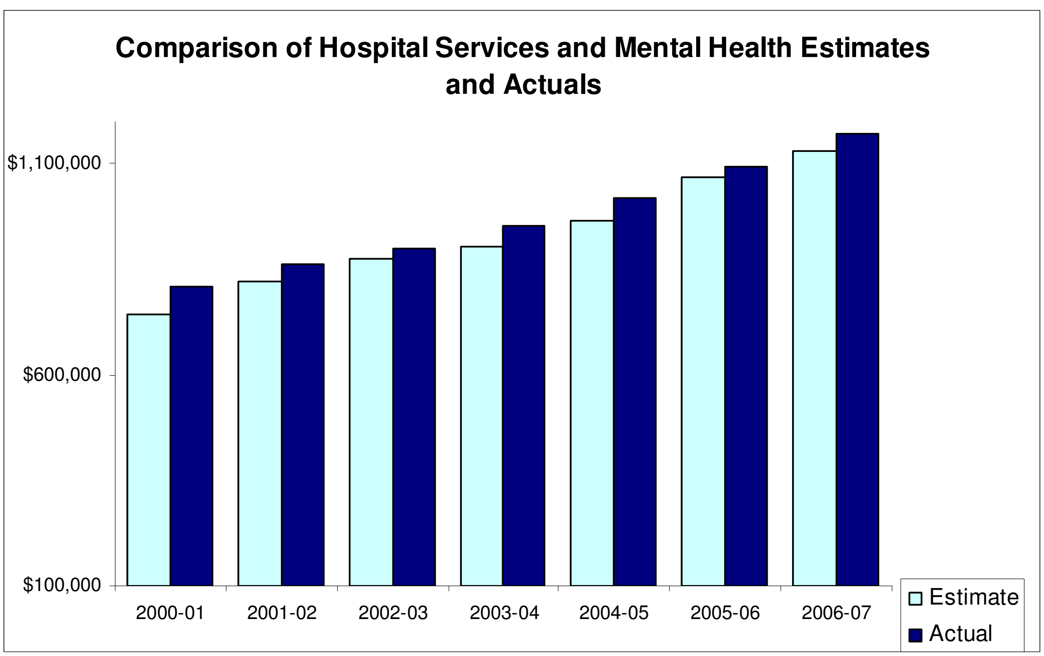
Three of the Province's pension plans, the Public Service Superannuation Plan (PSSA), the Teachers Pension Plan (TPA) and the Judges Pension Act, have a legislative requirement to make special payments to ensure the plans are fully funded. Special payments were resumed in fiscal 2004 and the PSSA and TPA are now 92.1% and 95.6% funded respectively. The Province should continue to monitor the funding ratios for these plans and adjust payments as required to ensure that the plans are adequately funded.

Recurring Deficits in the Regional Health Authorities

As shown in Figure 1 below, actual spending on Hospital Services and Mental Health Services, the two largest RHA programs, have exceeded budgets over at least the past 6 years. Budgets for these programs have not been established to reflect the 6.5% historical annual increase over prior year spending. As a result, RHA's carry forward a cost structure that exceeds their allocated funding.

Figure 1 - Comparison of Hospital Services and Mental Health Estimates and Actuals

(in thousands of dollars)



In addition, recurring deficits at the RHAs are attributable to following causes:

- RHA budget targets are not supported by assumptions of activity or workload;
- RHAs do not submit action plans to the Department of Health to address differences between target funding and requested funding;
- RHA internal budgets exceed Department of Health funding targets;
- RHA business plans are not approved by the Department of Health;
- RHA funding approvals are not received until 1/3 of the fiscal year is complete;
- Multi-year funding approval or direction is not provided;
- No in-year direction is provided; and
- RHA deficits are funded at year end in the form of working capital grants but the funding base adjustment is delayed.

Recurring Deficits for Out of Province Hospital Payments

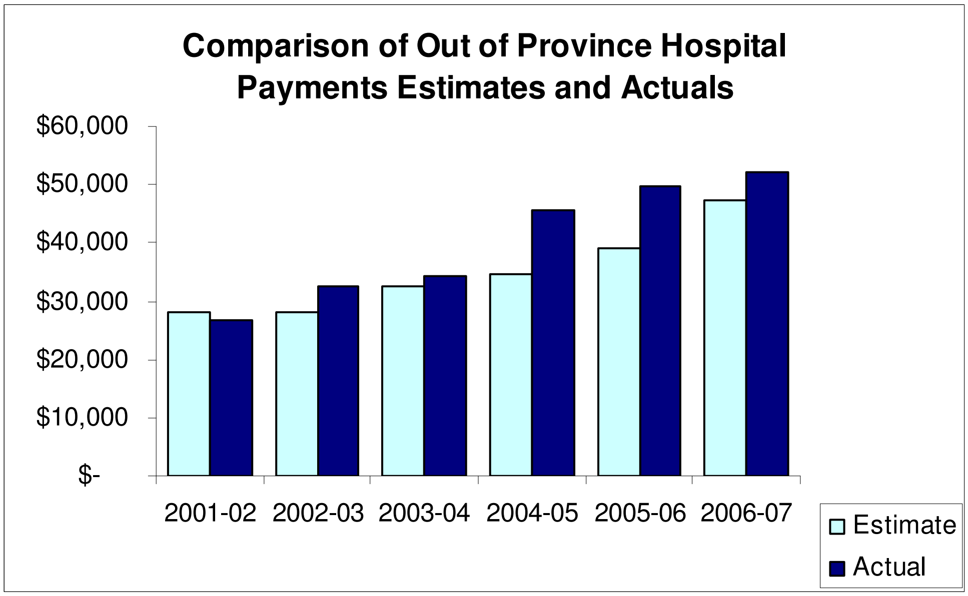
Actual expenditures for Out of Province Hospital payments increased by a total $22.8 million between 2001-02 and 2005-06 or an average of $5.7 million annually. In percentage terms, this represents growth of between 5.8% and 32.5% annually. Rates for Out of Province Hospital Payments are set by a national committee or by the hospital providing services.

As shown in Figure 2, the Estimates for Out of Province Hospital Payments have typically been increasing annually but have not been increased in comparison to prior year actual spending. For 2006-07, the Main Estimates established a funding level for Out of Province Hospital Payments that was lower than actual costs for 2005-06. The estimates for Out of Province Hospital Payments are not supported by any assumptions about referral patterns or volumes of activity to provide the basis for establishing estimates.

As a result, the Department of Health has incurred deficits related to Out of Province Hospital Payments for the past five years.

Figure 2 - Comparison of Out of Province Hospital Payments Estimates and Actuals

(in thousands of dollars)



Recommendations

The terms of reference provided by the Province for this independent review requested recommendations based on the results of the review. The recommendations resulting from this review are provided below.

Loans and Provisions

1 The Province should ensure that an effective collection system for default student loan accounts is put in place as soon as possible to minimize future student loan losses.

Tangible Capital Assets

2 The Province should consider developing a long-term capital acquisition or management plan to provide guidance on annual capital acquisitions and to ensure changes to net debt related to capital acquisitions do not exceed planned levels.

3 The Province should review the current Tangible Capital Asset accounting policies of all entities within the Government Reporting Entity and assess the reasonableness and consistency of amortization rates, capital thresholds and identified asset classes.

4 The Province should evaluate the appropriateness of its amortization rates and capitalization thresholds based on a reasonable period of actual experience and based on the experience of other comparable provinces. This review should consider whether amortization rates appropriately reflect the useful life of the Province's assets and if the corresponding amortization expenses appropriately reflect the consumption of assets in the delivery of services.

5 The Province should continue to monitor evolving guidance from PSAB with respect to Tangible Capital Asset accounting to allow it to plan and manage Tangible Capital Assets appropriately.

Governance

6 The Province should review its overall governance of NB Power and eliminate the perceived inconsistency between its intended policy to have NB Power operate as a commercial enterprise and its actions in terms of limiting NB Power's ability to set rates through the Public Utilities Board that will allow NB Power to fund its operations and debt obligations.

7 The Province should consider its role in reviewing NBIMC's actual results, and reviewing NBIMC budgets and strategy to ensure that they are consistent with the Province's expectations of NBIMC. This will allow the Province and NBIMC to ensure that they share a clear and common understanding of acceptable risk and growth targets consistent with the Province's fiscal objectives.

8 The Province should consider its role in reviewing ANBL's actual results and reviewing ANBL's budgets and strategy to ensure that they are consistent with the Province's expectations of ANBL. This will allow the Province and ANBL to ensure that they share a clear and common understanding of acceptable risk and growth targets consistent with the Province's fiscal objectives.

Nursing Homes

9 The Province should review and update the Nursing Home Act and Regulations as required to reflect changes in the sector, and to update the governance and financial relationships between the Province and nursing homes.

10 The Province should develop a long-term plan for future phases of capital upgrades to nursing homes which may require refurbishments over the next ten to fifteen years, to assist the Government in future budget planning.

11 The Province should continue to encourage nursing home financing amortization periods of no more than 20 years, to reflect the expected lifespan of facilities improvements, and the fixing of rates for between 10 and 20 years, to take advantage of relatively low interest rates.

12 Given the growing demands on nursing homes and the changes to funded hours of care, the Province should investigate the need to train additional registered nurses, nursing assistants and resident attendants to meet future staffing needs.

13 The Province should continue to assess whether changes to funding policies and the resulting impact on the proportion of funding that nursing homes receive from the Province have any impact on the Province's judgement as to whether or not government controls nursing homes as defined in PSAB.

Pension Plans

14 The Province should consider developing an accounting policy respecting pensions. A documented policy may include those items indicated in section 7.2.2.

15 The Province should develop an inventory of pension plan obligations recorded across the Government Reporting Entity and its agencies to ensure all benefits have been completely and appropriately accounted for.

16 The Province should review the basis for the segregation of NB Power's pension amounts and PSSA assets in the actuarial calculations related to the PSSA pension plan and determine whether similar segregated calculations should be performed for other provincial agencies.

17 The Province should continue to monitor the results of all actuarial valuations performed and ensure any new information is adequately addressed for accounting and funding purposes. The Early Retirement Plan valuation should be reviewed closely as there may be new trends emerging given that the last valuation on this plan was performed in the mid 1990's.

Retirement Allowance Benefits

18 The Province should determine the most appropriate accounting treatment for the incremental estimated liability related to retirement allowance benefits and the related note disclosure.

19 The Province should consider commissioning an actuarial valuation using current data to estimate the liability of retirement allowance benefits.

20 The Province should develop an accounting policy respecting retirement allowance benefits. A documented policy may include those items indicated in Section 8.2.

21 The Province should develop an inventory of benefit programs offered within the Government Reporting Entity to ensure all benefits have been completely and appropriately accounted for.

22 The Province should consider changing the terminology it uses to refer to various benefit programs to be consistent with PSAB guidance to promote clarity in the interpretation of accounting guidance related to these benefit programs.

23 In making any future changes to the Government Reporting Entity, the Province should continue to consider all additional accounting and reporting requirements and allow appropriate lead times to prepare required information, such as actuarial valuations and other estimates.

Regional Health Authorities (RHAs)

24 The Province should develop an updated Provincial Health Plan, including a clinical services plan. This planning process should evaluate the cost of providing the current health system, and establish funding targets based on the levels of activity and workload required to support the Province's objectives for the health system, as identified in the updated Provincial Health Plan.

25 The Department of Health business planning process should be revised to provide direction to RHAs about the changes to their services and service delivery models that should be undertaken to allow the RHAs to operate within their approved levels of funding. This would allow RHAs to develop internal plans and budgets that are consistent with the Department of Health approved funding levels.

26 Consideration should be given to having the Department of Finance provide the Department of Health and RHAs with multi-year funding targets for business planning purposes. This would permit the introduction of changes to services and service delivery models to minimize disruptions to the system and to citizens.

Out of Province Hospital Payments

27 The annual budgeting process for Out of Province Hospital payments should consider explicitly the approved rate increases set by the Inter provincial Health Insurance Agreements Coordinating Committee, any known increases in facility-specific rates, and any other known changes in availability of services.

28 The Department of Health is encouraged to use the information from the new Out of Province Hospital Payments reporting model to monitor the nature of Out of Province services to better understand the underlying causes of increases in costs related to Out of Province Hospital Payments. While the Department cannot deny payment for residents who receive services Out of Province, analysis of the underlying nature of these services will provide the Department with better information to inform health services planning, and to influence health care service delivery in New Brunswick.

Introduction

Terms of Reference

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1. the difference in projected revenues, spending and fiscal results to year end when compared to the 2006-07 Main Estimates; including provision for losses in loans and advances portfolios;
2. the Province's adoption of the CICA Public Sector Accounting Board accounting for Tangible Capital Assets and the future implications of this approach with respect to Net Debt and debt obligations;
3. an estimate of the Province's future obligations including the twinning of the Trans-Canada Highway (Longs Creek to Grand Falls);
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6. the Province's relationship and funding of nursing homes including any future obligations for construction and renovation projects;
7. the funding status of public sector pension plans;
8. the accounting for retirement allowances excluding pension plans;
9. the repetitive nature and cause of Regional Health Authority deficits; and
10. the repetitive nature and cause of Out of Province Hospital Payment deficits.

The objective of the review was to provide the Province with an overview of its financial position for the current fiscal year and to identify the fiscal implications of the Province's current programs and commitments for future fiscal years. This report is presented in accordance with the ten items outlined in the Terms of Reference. For each area considered, the report provides:

- background information related to the issue under review;
- the forecast for 2006-07;
- an explanation of material variances (material variances are defined as those variances resulting from significant changes to assumptions used in the Main Estimates or variances resulting from actual experience differing significantly from expected results at the time the Main Estimates were prepared);
- a description of any known risks or uncertainties related to the forecast for 2006-07;
- the implications of forecast results for 2006-07 or any other decisions or issues on the future fiscal results of the Province; and
- recommendations for managing fiscal results in the future relevant to the Terms of Reference for this independent review.

This information will provide the basis from which the Province can make decisions about the introduction and management of programs to meet its fiscal and program objectives.

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The Deputy Minister of Finance and the Comptroller have provided written assurance that, to the best of their knowledge, all requested data and information has been provided for our consideration.

Background on Public Sector Accounting Board Standards and Guidelines

The Canadian Institute of Chartered Accountants (CICA) provides standards and guidelines for accounting in the public sector through its Public Sector Accounting Board (PSAB). These standards and guidelines provide a framework for the Province in determining its accounting practices and policies. The following Sections of the PSAB Handbook were consulted for this review and are referenced in appropriate sections of this report:

- Public Sector (PS) 1300 – Government Reporting Entity
- PS 3150 – Tangible Capital Assets;
- PS 3250 – Retirement Benefits; and
- PS 3255 – Post-employment Benefits, Compensated Absences and Termination Benefits.

PS 1300 – Government Reporting Entity

This Section applies to the financial statements of the federal, provincial, territorial and local governments in Canada. It provides guidance on the definition and accounting treatment of public sector organizations that are not formal government departments, but are controlled by government. A key determinant in the designation of an organization to be included in the Government Reporting Entity is the amount of control exerted by government on the organization. PS 1300 indicates "Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities."

Government financial statements are to include accounting for all related Government organizations. This is done in one of two ways:

- Consolidation method – combines the accounts of the Government organization with the government line-by-line on a uniform basis of accounting and eliminates inter-organizational balances and transactions.
- Modified equity method – Government financial statements include only a single entry for the Government organization to reflect the entity's earnings/losses. Assets, liabilities (including debt) and equity are not consolidated onto the Government's financial statements.

The modified equity method applies to Government organizations designated as Government Business Enterprises. These enterprises are self-sustaining, and demonstrate the following characteristics:

- Separate legal entity with power to contract in its own name, and can sue or be sued;

- Has delegated authority for financial and operational matters to conduct business;
- Principal activity is to sell goods and/or services to individuals and/or organizations outside the Government Reporting Entity; and
- Ability to maintain its operations and meet liability requirements from revenues received from sources outside the Government Reporting Entity.

The consolidation method is used for all other Government organizations unless their operations are not material.

PS 3150 – Tangible Capital Assets

This publication provides accounting standards for Tangible Capital Assets effective for fiscal years beginning on or after April 1, 2005. The Province adopted these new standards for its March 31, 2005 financial statements, one year earlier than required.

Prior to the introduction of these new standards, the cost of Tangible Capital Assets was reported as an expenditure in the year of acquisition.

The new accounting standards for Tangible Capital Assets require tangible capital asset acquisitions be recorded on the Province's financial statements as non-financial assets rather than expenses. Non-financial assets are, in turn, written off through amortization expenses, over the estimated useful life of the related tangible capital asset. The Province has established various thresholds to record tangible capital assets.

The impact of the introduction of this new accounting policy for Tangible Capital Assets is that, because amortization expenses do not match net acquisitions of capital assets, the change in the Province's net debt is no longer equal to the Province's annual surplus or deficit.

PS 3150 does not provide specific guidance with respect to amortization rates, eligible capital thresholds and asset classifications. It allows each organization to determine these definitions based on specific circumstances and professional judgment. As a result, practices and polices vary between provinces and, to some extent, vary across New Brunswick Government organizations.

PSAB continues to issue updates to accounting guidelines related to Tangible Capital Assets. For example, an update issued in September, 2006 provides further guidance on the disclosure of information related to Tangible Capital Assets.

Recently, PSAB issued an exposure draft which proposes further changes to the guidelines for accounting for Tangible Capital Assets. As it is currently written, this guideline will result in a requirement for the Province to recognize funding for capital assets received from other governments to be recognized in the year of receipt, rather than the current accounting treatment which matches revenues and expenditures. This exposure draft is subject to change.

PS 3250 – Retirement Benefits
Section 3250 identifies two types of pension plans:

- defined benefit plans, which prescribe the benefit to be supplied at retirement and require the employer to ensure adequate assets exist to fund the related future pension obligations; and
- defined contribution plans, which prescribe the present contribution amounts required rather than the specific future retirement benefits to be paid. For these plans, the residual risk rests with the employees, given the current cash contribution is determined, but the exact future retirement benefits to be received by the employee remain unknown and subject to market impacts.

PS 3255 – Post-employment Benefits, Compensated Absences and Termination Benefits
Effective on or after January 1, 2004, this Section defines three broad categories of benefits related to an employee leaving employment – post-employment benefits, compensated absences and termination benefits. Termination benefits are defined as:

- benefits required to be provided to employees under the existing terms of a benefit arrangement when a specific event occurs that results in the downsizing and termination of a group of employees; or
- special termination benefits that are not contractual termination benefits and are offered to employees for a short period of time, normally not exceeding twelve months, in exchange for employees' voluntary or involuntary termination of employment.

1. Current Fiscal Year Review

To review, comment and make recommendations regarding differences in projected revenues, spending and fiscal results to year end, when compared to the 2006-07 Main Estimates; including provision for losses in loans and advances portfolio.

1.1 Procedures

Based on information from discussions with Provincial representatives and a review of documents provided by the Province, Grant Thornton LLP:

- documented material year-to-date variances in revenues, expenditures and fiscal results and the causes of these variances based on information;
- documented key underlying assumptions for significant budget items in the 2006-07 Main Estimates, the value assumed in the 2006-07 Main Estimates, the range of values that could occur in fiscal 2006-07 and any contingencies/commitments/guarantees that could impact the Province's fiscal results based on information;
- documented the financial impact of programs announced by the new government, based on a review of information;
- identified the potential range of the variance in projected revenues, expenditures and fiscal results based on the range of values that could occur in fiscal 2006-07, any contingencies/commitments/guarantees, and the government's new programs;
- documented the amounts and basis for the provisions for losses in loans and advances included in the 2006-07 Main Estimates; and
- assessed the amounts and basis for provisions for losses in loans and advances included in the 2006-07 Main Estimates.

1.2 Forecast 2006-07

The Main Estimates tabled on March 28, 2006 included a planned surplus of $22.2 million and an increase in net debt of $87.0 million. This planned surplus was significantly less than the actual surplus of $243.7 million realized in 2005-06.

Based on actual expenditures and revenues to date, decisions taken subsequent to the approval of the Main Estimates and projections about expenditures and revenues to March 31, 2007, before considering risks and uncertainties, the Province is forecasting a deficit of $17.6 million and an increase in net debt of $156.7 million.

Outlined below is a summary of the forecast fiscal results for 2006-07 followed by tables that provide a further break-down of the forecast for Ordinary Revenues, Ordinary Expenditures, Special Purpose Accounts and Special Operating Agencies and the Capital Account and Adjustments for Tangible Capital Assets[1]. This forecast includes the impact of decisions made by government.

[1]Numbers may vary based on rounding

Table 1-1 Comparative Statement of Surplus or Deficit

(in thousands of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Budgetary Accounts				
Ordinary Account				
Revenues	$ 5,945,058	$ 5,882,645	$ 5,951,634	$ 68,989
Expenditures	5,705,757	5,798,433	5,912,785	(114,352)
Surplus (Deficit)	239,301	84,212	38,849	(45,363)
Special Purpose Account				
Revenues	53,345	52,289	56,683	4,394
Expenditures	46,460	55,533	56,846	(1,313)
Surplus (Deficit)	6,885	(3,244)	(163)	3,081
Special Operating Agency				
Revenues	70,666	65,403	80,116	14,713
Expenditures	36,709	54,654	77,533	(22,879)
Surplus (Deficit)	33,957	10,749	2,583	(8,166)
Sinking Fund Earnings	226,367	229,700	229,700	-
Capital Account				
Revenues	30,107	28,256	29,135	879
Expenditures	405,313	436,664	456,800	(20,136)
Surplus (Deficit)	(375,206)	(408,408)	(427,665)	(19,257)
Adjustment for Tangible Capital Assets	112,370	109,215	139,145	29,930
Surplus (Deficit)	**$ 243,675**	**$ 22,224**	**$ (17,551)**	**$ (39,775)**

Note: Risks and Uncertainties detailed in Section 1.4 of this report could significantly alter this 2006-07 forecast by March 31, 2007.

Table 1-2 COMPARATIVE STATEMENT OF ORDINARY ACCOUNT REVENUE

(in thousands of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Budgetary Accounts				
Taxes				
Personal Income Taxes	$ 1,063,638	$ 1,104,700	$ 1,142,400	$ 37,700
Corporate Income Taxes	150,311	178,400	161,600	(16,800)
Metallic Minerals Tax	10,475	8,000	19,000	11,000
Provincial Real Property Tax	340,962	353,200	353,200	-
Harmonized Sales Tax	838,662	814,300	819,500	5,200
Gasoline & Motive Fuels Tax	232,090	236,300	210,600	(25,700)
Tobacco Tax	90,470	93,000	88,000	(5,000)
Pari-Mutuel Tax	73	65	53	(12)
Insurance Premium Tax	39,447	41,200	40,582	(618)
Real Property Transfer Tax	5,559	6,000	6,000	-
Large Corporation Capital Tax	36,292	33,900	33,900	-
Financial Corporation Capital Tax	9,542	10,000	10,000	-
	2,817,521	2,879,065	2,884,835	5,770
Return on Investment				
Net Income - NB Liquor	126,053	127,000	127,734	734
Net Income - NB Electric Finance Corp.	131,598	(46,000)	1,000	47,000
Net Income - NB Securities Commission	6,539	5,100	5,382	282
Subtotal - Net Income	264,190	86,100	134,116	48,016
Interest & Other Investment Income	31,555	28,619	29,513	894
Other	-	4,089	4,091	2
	295,745	118,808	167,720	48,912
Licenses & Permits				
Motor Vehicle	91,339	90,258	92,458	2,200
Liquor Control and Regulation	943	870	870	-
Fish & Wildlife	4,101	3,996	4,014	18
Forests		216	318	102
Mines	1,324	955	1,383	428
General	7,812	7,191	7,223	32
	105,519	103,486	106,266	2,780

Table 1-2 COMPARATIVE STATEMENT OF ORDINARY ACCOUNT REVENUE (Continued)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Sales of Goods and Services	219,689	209,237	207,271	(1,966)
Royalties				
Forests	56,914	57,250	53,650	(3,600)
Mines	10,940	10,026	10,024	(2)
	67,854	67,276	63,674	(3,602)
Lottery Revenues	109,991	110,125	112,125	2,000
Fines & Penalties	1,784	1,486	1,529	43
Miscellaneous	18,573	14,670	15,636	966
TOTAL OWN SOURCE REVENUE	**3,636,677**	**3,504,153**	**3,559,056**	**54,903**
Unconditional Grants - Canada				
Fiscal Equalization Payments	1,347,993	1,432,200	1,450,799	18,599
Canada Health and Social Transfer	1,032	-	-	-
Health Reform Transfer	5	-	-	-
Canada Health Transfer	488,199	490,200	483,200	(7,000)
Canada Social Transfer	207,146	211,600	207,900	(3,700)
Other	1,866	1,900	1,900	-
	2,046,241	2,135,900	2,143,799	7,899
Conditional Grants - Canada				
General Government Services	32,100	35,716	31,416	(4,300)
Transportation	85	85	85	-
Economic Development	4,420	5,670	5,670	-
Health	80,467	66,593	69,356	2,763
Welfare	4,728	4,728	4,728	-
Education	135,447	125,015	130,941	5,926
Other	4,893	4,785	6,583	1,798
	262,140	242,592	248,779	6,187
Total	**$ 5,945,058**	**$ 5,882,645**	**$ 5,951,634**	**$ 68,989**

TABLE 1-3 COMPARATIVE STATEMENT OF ORDINARY ACCOUNT EXPENDITURES

(in thousands of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Budgetary Accounts				
Agriculture, Fisheries and Aquaculture	$ 32,524	$ 32,841	$ 32,834	$ 7
Business New Brunswick	33,420	37,407	37,407	-
Education	843,289	829,550	842,476	(12,926)
Energy	2,239	2,317	2,317	-
Energy Efficiency and Conservation Agency of NB	818	8,031	8,031	-
Environment	54,621	13,849	14,224	(375)
Executive Council Office	2,856	7,131	7,081	50
Family and Community Services	752,886	789,533	800,933	(11,400)
Finance	77,479	12,465	12,325	140
General Government	431,407	450,894	449,890	1,004
Health	1,798,924	1,896,760	1,960,385	(63,625)
Intergovernmental Affairs	3,167	3,048	3,047	1
Justice and Consumer Affairs	48,609	34,921	35,464	(543)
Legislative Assembly	17,419	18,123	23,605	(5,482)
Local Government		110,416	110,849	(433)
Maritime Provinces Higher Education Commission	258,464	147,542	147,541	1
Natural Resources	93,657	94,453	95,017	(564)
Office of the Attorney General		13,721	14,348	(627)
Office of the Comptroller	4,475	4,915	4,915	-
Office of Human Resources	5,395	5,771	5,771	-
Office of the Premier	1,140	1,179	1,178	1
Post-Secondary Education and Training	194,906	238,724	246,724	(8,000)
Public Safety	100,088	102,570	103,210	(640)
Regional Development Corporation	43,445	38,505	43,141	(4,636)
Service of the Public Debt	591,345	575,143	576,900	(1,757)
Supply and Services	95,997	97,697	100,097	(2,400)
Tourism and Parks	25,609	25,287	25,437	(150)
Transportation	164,299	158,859	160,459	(1,600)
Wellness, Culture and Sport		16,379	16,379	-
	5,678,478	5,768,031	5,881,985	(113,954)
Designated Revenue	27,279	30,402	30,800	(398)
Total Gross Expenditures	**$ 5,705,757**	**$ 5,798,433**	**$ 5,912,785**	**$ (114,352)**

TABLE 1-4 COMPARATIVE STATEMENT OF SPECIAL PURPOSE ACCOUNT REVENUES

(in thousands of dollars)

Special Purpose Accounts	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Education	$ 21,932	$ 10,655	$ 10,655	$ -
Environment	6,258	5,187	7,818	2,631
Family and Community Services	11,738	12,737	12,737	-
Finance	56	56	57	1
General Government	2,181			-
Health and Wellness	1,766	1,335	1,735	400
Justice and Consumer Affairs	449	449	449	-
Natural Resources and Energy	2,443	2,502	2,508	6
Post Secondary Education, Training and Labour	579	9,362	9,443	81
Public Safety	4,475	6,884	6,361	(523)
Supply and Services	1,416	1,055	2,858	1,803
Tourism and Parks	52	55	50	(5)
Wellness, Culture and Sport		2,012	2,012	-
Total	**$ 53,345**	**$ 52,289**	**$ 56,683**	**$ 4,394**

TABLE 1-5 COMPARATIVE STATEMENT OF SPECIAL PURPOSE ACCOUNT EXPENDITURES

(in thousands of dollars)

Special Purpose Accounts	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Education	$ 21,286	$ 10,655	$ 10,655	$ -
Environment	5,023	5,600	7,349	(1,749)
Family and Community Services	7,943	14,500	14,500	-
Finance	56	56	56	-
General Government	2,005			
Health and Wellness	1,813	1,335	1,735	(400)
Justice and Consumer Affairs	449	449	449	-
Natural Resources and Energy	2,337	2,626	2,388	238
Post Secondary Education, Training and Labour	321	9,361	9,449	(88)
Public Safety	3,942	7,320	6,585	735
Supply and Services	1,242	1,613	1,613	-
Tourism and Parks	43	55	55	-
Wellness, Culture and Sport	-	1,963	2,012	(49)
Total	**$ 46,460**	**$ 55,533**	**$ 56,846**	**$ (1,313)**

TABLE 1-6 COMPARATIVE STATEMENT OF SPECIAL OPERATING AGENCIES REVENUES

(in thousands of dollars)

Special Operating Agency	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Post Secondary Education, Training and Labour	$ 107,715	$ 101,398	$ 109,765	$ 8,367
Public Safety	5,090	5,541	5,596	55
Regional Development Corporation	45,531	47,977	56,418	8,441
Tourism and Parks	905	915	880	(35)
Transportation	76,009	79,114	80,514	1,400
	235,250	234,945	253,173	18,228
Less: Interaccount Transactions	(164,584)	(169,542)	(173,057)	(3,515)
Total	**$ 70,666**	**$ 65,403**	**$ 80,116**	**$ 14,713**

TABLE 1-7 COMPARATIVE STATEMENT OF SPECIAL OPERATING AGENCIES EXPENDITURES

(in thousands of dollars)

Special Operating Agency	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Post Secondary Education, Training and Labour	$ 107,942	$ 101,398	$ 109,765	$ (8,367)
Public Safety	4,785	6,005	6,205	(200)
Regional Development Corporation	25,291	49,473	65,900	(16,427)
Tourism and Parks	913	1,186	1,186	-
Transportation	62,362	66,134	67,534	(1,400)
	201,293	224,196	250,590	(26,394)
Less: Interaccount Transactions	(164,584)	(169,542)	(173,057)	3,515
Total	**$ 36,709**	**$ 54,654**	**$ 77,533**	**$ (22,879)**

TABLE 1-8 CAPITAL ACCOUNT EXPENDITURES

(in thousands of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Agriculture, Fisheries and Aquaculture	$ 395	$ 400	$ 400	$ -
Education	965	1,000	1,000	-
Environment	1,537	400	400	-
Health	37,088	13,723	14,283	560
Local Government		930	930	-
Natural Resources	1,721	1,615	1,615	-
Regional Development Corporation	13,753	16,900	17,200	300
Supply and Services	108,889	157,666	169,777	12,111
Tourism and Parks	1,885	1,200	1,200	-
Transportation	239,080	242,830	249,995	7,165
Totals	$ 405,313	$ 436,664	$ 456,800	$ 20,136

1.3 Material Variances from Main Estimates

Outlined below is an explanation of material variances between the Main Estimates and the 2006-07 forecast. Variances are described in thousands of dollars.

1.3.1 Material Variances related to Ordinary Revenue

Outlined below are explanations for material variances between the Main Estimates and the forecast for 2006-07 related to Ordinary Revenues.

Personal Income Taxes and Corporate Income Taxes	The Estimate for personal and corporate income taxes is based on the information that is available from the Federal government at the time the Estimates are prepared. Further information from the Federal government indicates that there will be increases in personal income taxes of approximately $37.7 million and decreases in corporate income taxes of ($16.8) million as compared with the Estimate.	$20,900.0
Metallic Minerals Tax	Metallic minerals tax revenue fluctuates with the world price of metallic minerals. The legislation imposes a two-tier tax on all metallic minerals production. Each year the operator of a mine shall pay a tax equal to a) 2% of net revenue for the year, and b) 16% of net profits in excess of $100,000 for the year. The current world prices for	$11,000.0

	metallic minerals are higher than were anticipated when the Estimates were prepared.	
Harmonized Sales Tax and Gasoline and Motive Fuels Tax	The costs of the gas tax reduction of $0.038 per litre along with lower than expected gas and motive fuels sales to date are anticipated to have a negative impact on revenues as compared with the Main Estimates. This negative impact is partially off-set by new estimates from the Federal government which indicate that HST revenues will be higher than anticipated when the Estimates were prepared.	($20,500.0)
Tobacco Tax	Tobacco sales to date have been lower than were anticipated when the Estimates were prepared.	($5,000.0)
Income related to NBEFC	An estimated loss of $46 million for NBEFC was included in the Estimates. Due to favourable weather conditions and a range of other variables, NBEFC is now forecasting an income of $1 million.	$47,000.0
Motor Vehicle License Revenue	Actual motor vehicle license revenues to date indicate that these revenues will exceed the amount expected when the Estimates were prepared.	$2,200.0
Sale of Goods and Services	Actual revenues to date from sales of goods and services from other agencies to date indicate that these revenues will not meet the level when the Main Estimates were prepared.	($1,966.0)
Forest Royalties	The actual revenue received from forest royalties has decreased primarily from government approved initiatives around the creation of two softwood pulpwood classes (Groundwood and Kraft pulp) that have effectively reduced the royalty payments to assist the forest industry. .	($3,600.0)
Lottery Revenues	Actual revenues from lotteries to date indicate that there will be a net increase in lottery revenues as compared with the Estimate.	$2,000.0

Equalization Payments	The announced fixed payments from the Federal government that were not known at the time of preparing the Main Estimates are expected to have a positive impact on the revenues of the Province.	$18,599.0
Canada Health Transfer and Canada Social Transfer	The Estimates for Canada Health Transfer and Canada Social Transfer are based on the information that is available from the Federal government at the time the Estimates are prepared. Further information from the Federal government indicates that revenues from this source will fall short of the amounts included in the Main Estimates.	($10,700.0)
Conditional Grants from the Federal Government	Conditional grants are provided by the Federal government for specific programs. Since the Estimates were tabled, additional Federal government conditional grants for official languages programs were identified. This is off-set to some extent by a short-fall in anticipated revenues related to the Energuide program.	$6,187.0

1.3.2 Material Variances related to Ordinary Expenditures

Outlined below are explanations for material variances between the Main Estimates and the forecast for 2006-07 related to Ordinary Expenditures.

Education	The expected increase in costs in the Department of Education as compared with the Main Estimates are primarily related to the following: • ($4.7 m) related to official languages education program for which the Province has received conditional grants from the Federal government. • ($5.0 m) related to the implementation of measures contained in the MacKay Report on Inclusive Education • ($2.4 m) related to the expansion of the Laptop Project • ($0.8 m) cost pressures in corporate services	($12,926.0)

Family and Community Services	Changes to the introduction of new funding policies for the long term care program including: • Elimination of requirement for use of personal assets • Maximum user-pay per diem rates • Increase in hours of care in nursing homes • Increases in hours of care for in-home care	($11,400.0)
General Government	Improvements in the returns of pension investments and positive variances with respect to wage settlements off-set by increases in the retirement allowance benefits expense related to new information received in a recent draft valuation report for the retirements allowance benefits program. The retirement allowance variance is further discussed in Section 8 of this report.	$1,004.0
Health – Regional Health Authorities	The Regional Health Authorities forecasted spending level reflects last year's spending levels plus cost increases and approved new programs. Adjustments for last year's RHA deficits were not included in the budget amounts for RHAs in the Main Estimates creating a variance between forecast spending and budget. This variance is further discussed in Section 9 of this report.	($45,987.2)
Health - Medicare	The actual contractual increases for fee-for-service physicians exceeded the assumptions available at the time the Main Estimates were prepared.	($13,800.0)
Health – Out of Province Hospital Payments	The year to date costs related to payments for hospital services provided to New Brunswick residents by facilities outside of the Province is expected to be greater than originally estimated. This variance is further discussed in Section 10 of this report.	($4,846.1)
Legislative Assembly	The Main Estimates did not include an amount to fund costs related to the election.	($5,482.7)

Post Secondary Education and Training - Grants to First Time Students	The new program, which will provide grants to first time university students, was not provided for in the Main Estimates.	($8,000.0)
Regional Development Corporation (RDC)	RDC will direct $2.22 million in additional funds towards special community development initiatives that arise throughout the year and are not budgeted in other governmental departments. In addition, the RDC has spent an additional $2.416 million for Fund Management and Administration made up primarily of • $600,000 on various initiatives under the Community Economic Development Fund; and • the introduction of programs related to the French Language Services Agreement ($1 million for Complementary Projects and $500,000 for the Francophone Summit) and $200,000 for administration of the Gas Tax Transfer Fund all of which are off-set by funds from the Federal government.	($4,636.6)
Service of the Public Debt	The costs related to servicing public debt are expected to be higher than estimated as a result of the need to finance over-expenditures and a decline in conditions in the market as compared with the conditions assumed at the time the Main Estimates were prepared.	($1,757.0)
Supply and Services	Supply and Services are expecting a negative variance from the Main Estimates due largely to grants in lieu of municipal property taxes ($1.45 million), rising energy costs ($250,000), rising property management and other costs ($349,000) and additional expenses associated with the RFP for Radio Communication. ($350,000)	($2,400.0)
Transportation	The costs related to fuel and ferry operations are expected to be higher than estimated at the time the Main Estimates were prepared.	($1,600.0)

1.3.3 Material Variances related to Special Purpose Accounts

Outlined below are explanations for material net variances between the Main Estimates and the forecast for 2006-07 related to Special Purpose Accounts.

Environmental	Both revenues and expenditures relating to the Environmental Trust Fund were greater than budgeted for in the Main Estimates	$882.0
Supply and Services	The Department of Supply and Services is forecasting increased revenue from property sales during the remainder of the fiscal year	$1,803.0

1.3.4 Material Variances related to Special Operating Agencies

Outlined below are explanations for material variances between the Main Estimates and the forecast for 2006-07 related to Special Operating Agencies.

Regional Development Corporation	New federal funding subsequent to preparation of the budget was announced relating to a Salmon Aquaculture Fund; School Community Centers; infrastructure programs and other initiatives.	$8,441.0
Regional Development Corporation	RDC has had significant expenditures relating to assistance to the Salmon Aquaculture Industry, payments to francophone schools and payments under the Canada-NB Gas Tax Transfer Fund for which revenues were received in the previous fiscal year.	($16,427.0)

1.3.5 Material Variances related to Tangible Capital Assets

Outlined below are explanations for material variances between the Main Estimates and the forecast for 2006-07 related to Tangible Capital Assets.

Supply and Services – Upper River Valley Hospital Project	Capital costs related to the Upper River Valley Hospital which were expected to be incurred in the prior fiscal year were not incurred until the current fiscal year, resulting in expected capital expenditures exceeding the amount provided in the Main Estimates.	($8,600.0)

Supply and Services – Education Projects	Capital costs related to improvements to various schools were in excess of budgeted amounts provided in the Main Estimates.	($3,449.0)
Transportation – Permanent Highways	Permanent highway improvements concerning a variety of projects as well as the Hanwell Road interchange completion in 2006-07 instead of 2007-08 and other increased costs for transportation capital projects related to increased fuel prices and asphalt prices.	($7,165.0)

In addition to the adjustments to tangible capital assets shown above, the Province has an adjustment related to its level of prepaid expenditures of $7.5 million.

1.4 Risks and Uncertainties related to the 2006-07 Forecast

Financial forecasts are based on assumptions about future events and circumstances, and actual events and circumstances may vary from these assumptions. As a result, the actual fiscal results and financial position of the Province at March 31, 2007 may vary from the forecast position provided in this report.

Outlined below are specific issues or circumstances that have been identified and may have an impact on the actual fiscal results of the Province for 2006-07. Variances are described in thousands of dollars.

1.4.1 Government Announcements

Outlined below are announced programs and initiatives not yet formally introduced. Should the government decide to introduce these programs in the current fiscal year; the forecast for 2006-07 will change, as these programs and initiatives have not been provided for in the Main Estimates.

MacKay Report	The government is in receipt of the January 2006 report, Connecting Care And Challenge: Tapping Our Human Potential - Inclusive Education: A Review Of Programming And Services In New Brunswick (commonly known as the MacKay Report). It made recommendations to assist the Government of New Brunswick to develop a policy framework for inclusive education; and to develop a model for an effective, accountable, inclusive education system which makes the best possible use of human and other resources, capitalizes on positive partnerships and responds to the particular requirements of each linguistic sector.	($7,500.0)
Energy Efficiency Rebates	The government announced its intention to introduce a program that would provide up to $2,000 per household to cover conservation-related upgrades, including most of the cost of a household energy audit and a tax rebate of $1,500 on the purchase or lease of a fuel-efficient hybrid vehicle.	($20,000.0)
Saint John Harbour Clean Up	The government has entered into a memorandum of understanding with the City of Saint John to contribute 1/3 of the estimated $88 million cost associated with the Saint John harbor clean up. The commencement of this initiative is dependent on the timing of federal and municipal contributions towards this project.	($29,300.0)
Saint John to Digby Ferry	The Government of New Brunswick obtained approval from the Provincial Cabinet and an Order in Council to provide funding of up to $2 million to the operator of the Saint John to Digby Ferry Service to ensure continued operation of the service and exploration of a sustainable business model for future operations. The timing related to this funding has not been finalized.	($2,000.0)
Inquiry into Orimulsion	The government has announced its intention to call a public inquiry into NB Power's arrangement to supply Venezuelan fuel to the Coleson Cove power plant.	($1,000.0)

Student Loans	The Province has announced a plan to eliminate the requirement to take parents' incomes into consideration when granting student loans. Presently, approximately $60 million of new student loans are granted each year. The Department expects this amount to increase dramatically under the proposed revision. Should this occur, the carrying cost of these loans to the Province, and loan loss provisions could also be expected to grow substantially. The estimated cost of the program change has not been determined.	No estimate known at this time
Debt Servicing Costs	The introduction of these announced programs and initiatives would result in incremental debt servicing costs.	($900.0)

1.4.2 Expired Collective agreements

The following collective agreements have expired and have not been renegotiated. While the Main Estimates made provision for negotiated wage settlements, the results of the negotiated contracts may have a positive or negative impact on the fiscal results of the Province in the current year.

Contract	Number of Funded Positions
Nursing I	348
TECH Group Laboratory & Medical and Technical Inspection	259
TECH Group Engineering & Field	463
CUPE 2745 Secretarial and Clerical	1,644

1.4.3 Federal Trust Funds

The Federal government has announced trust funds the Province can draw down based on the introduction of programs or initiatives within the funding parameters of these trust funds. It is anticipated any current year expenditures associated with the introduction of these programs or initiatives will be off-set by revenues from these trust funds and therefore will have no impact on the net financial results of the Province.

Public Transit Trust Fund	$20,700.0
Post-Secondary Education Infrastructure Fund	$23,100.0
Affordable Housing Trust Fund	$18,400.0
Off Reserve Aboriginal Housing Trust Fund	$6,700.0

1.4.4 Loan Provisions

Business New Brunswick Loans and Guarantees

Outlined below is a summary of the $364 million in outstanding balances for Business New Brunswick loans and guarantees at March 31, 2006. Balances related to the $194.9 million in allowances provided for against these loans and guarantees are shown in brackets. Essentially 53.5% of outstanding loan and guarantee balances are provided for as of the end of March, 2006.

Economic Development	$273.6m ($132.2m)
Fisheries	$71.9m ($49.3m)
Agriculture	$18.6m ($13.4m)

At March 31, 2006, the government increased loan loss provisions on Business New Brunswick loans and guarantees from $20 million to $44 million. This increase in the provision expense for 2005-06 was attributed to the Department's having done a thorough review of loans outstanding.

Discussions indicated that since the 2005-06 adjustment, there have not been material changes in portfolio conditions, and thus, the $20 million in provision allowances budgeted for Business New Brunswick loans and guarantees in the 2006-07 year appears appropriate.

Student Loans

In 2000, the Province introduced a student loan guarantee system that provided student loan guarantees to those banks that were involved with the student loan program. Prior to this, the Province had paid a risk premium to the banks on student loans, and the banks absorbed loan losses on defaults. Prior to May 1, 2005, the Province had paid out $15 million in student loan guarantees under the old program, 75% of which are currently provided for.

Effective May 1, 2005, the Province and the Federal Government entered into an agreement to integrate the federal and provincial student loan programs, at which time the Province purchased the existing student loan portfolios, comprising 35,000 loans, from the CIBC and National Bank.

Two service providers handle the student loan portfolios for the Province. However, once loans reach the point where they are 270 days in default, the Province assumes the responsibility for collection. Since the Province assumed responsibility for the student loans from the banks, collection activity has been limited to that provided by the two service providers. The Department of Post-Secondary Education, Training and Labour has been working on a draft agreement with the Federal Government to take advantage of the well-established Federal Integrated Collection System, and the Department is hoping to present this draft agreement to the Board of Management in the near future for consideration and approval.

In addition to the $15 million in accounts that were in existence prior to May 1, 2005, another $20 million has been added to the total accounts in default since that date, bringing the total to approximately $35 million at September 30, 2006. The total defaulted accounts balance has been growing by approximately $840,000 per month.

The $12.4 million provision for doubtful student loans budgeted for the 2006-07 year was based on the following assumptions:

- The allowance percentage applied would be consistent with prior periods.
- The Province would sign an agreement with the Federal Government to have the Federal Government handle the collection process for accounts in default

If the assumptions are not met, the amount of the loan provision may need to be adjusted.

1.4.5 Department of Education Accounts Receivable

As of March 31, 2006 The Department of Education had First Nations – Education receivables of $33 million comprising of $20.8 million in receivable amounts and $12.2 million in interest arrears. Although provisions of $10.3 million and $12.2 million have been made on the receivables and interest respectively, these provisions will have to be examined as to their adequacy for the 2006-07 fiscal year.

1.4.6 Nursing Home Pension Plan Deficiencies

Actuarial valuations of three nursing home pension plans have identified deficiencies. In March 2006, the Superintendent of Pensions issued an order for the nursing homes to make special payments to address the solvency deficiencies in the nurses and CUPE plans. The Nursing Homes Association appealed the order, and the appeal was heard on October 27, 2006. According to the Department of Family and Community Services, the adjudicator did not issue any ruling at the hearing, and there is no indication of an expected date for a ruling at this time.

These pension plans are not Provincial plans, and therefore, any funding requirement legally rests with the nursing homes. However, because the Province primarily provides the necessary funds to operate the nursing homes, there is uncertainty with regards to the funding of the deficiencies of the pension plans.

1.4.7 Nursing Home Funding Policies

The Government announced an intention to increase the comfort and clothing allowance for residents of nursing homes from $102 per month to $200 per month but has not announced the effective date for this change. It is estimated this increase will result in an incremental cost of $3.8 million per year.

1.4.8 Outbreak of Pandemic Flu

The Department of Family and Community Services' will incur an expense in the 2006-07 fiscal year of $2 million to fund the cost of creating a base level of supplies in anticipation of a potential outbreak of the pandemic flu. However, if a pandemic flu outbreak were to occur, the financial implications of the event could exceed the provision included in the 2006-07 Main Estimates significantly and have an impact on the Province's fiscal results in the current or future years.

1.4.9 Pension Plan Valuations

Updated actuarial reports are expected in the near future (for the TPA and Early Retirement Plans) and information from these valuations may impact the related pension expense calculations. Also, annual actuarial valuations for accounting purposes (effective date April 1, 2006) are currently being prepared on the PSSA and TPA plans. Updated information will become available as the actuarial process and related reporting unfolds, and may impact the 2006-07 forecast.

Overall pension asset performance will depend on the degree to which actual market performance and actuarial reporting varies from the assumptions used to prepare the 2006-07 Main Estimates.

1.4.10 Rate of Return on Pension Plan Assets

Rate of return on pension plan assets could have a significant impact on the fiscal results for 2006-07 related to pension expenses.

1.4.11 Retirement Allowance Benefits

The Public Sector Accounting Board (PSAB) guidelines related to termination benefits indicate that costs related to the following circumstances must be recognized as expense:

- benefits required to be provided to employees under the existing terms of a benefit arrangement when a specific event occurs that results in the downsizing and termination of a group of employees; and
- benefits that are not contractual termination benefits and that are offered to employees for a short period of time, normally not exceeding twelve months, in exchange for employees' voluntary or involuntary termination of employment.

The results of the recent valuation report prepared for the Province indicated an $80 million increase in the estimated liability related to the retirement allowance benefits program. There could be a fiscal impact for 2006-07 of up to $80 million, depending on the accounting treatment that the Province determines to be appropriate for this increase in the liability.

1.5 Implications for Net Debt

Based on the forecast for 2006-07, before consideration of any risk and uncertainties, the increase in net debt in 2006-07 is expected to be $156.7 million as compared with the $86.9 million increase in net debt provided in the Main Estimates.

TABLE 1-9 Changes to Net Debt

(in millions of dollars)

	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Surplus (Deficit)	**$ 22.2**	**$ (17.6)**	**$ (39.8)**
Adjustments for Tangible Capital Assets	$ (109.2)	$ (139.1)	$ (29.9)
(Increase) Decrease in Net Debt	**$ (87.0)**	**$ (156.7)**	**$ (69.7)**

1.6 Implications beyond 2006-07

The fiscal results and financial position of the Province beyond 2006-07, assuming no changes to existing programs or levels of service, will be determined primarily by:

- historical expenditure trends,
- previous decisions about programs and services; and
- the accounting interpretations the Province adopts related to certain items and actuarial assumptions and estimates related to significant liabilities.

1.6.1 Historical Expenditure Trends

Provincial health programs represent 32.9% of total program spending, 48.5% of which relates to hospital programs delivered by the Regional Health Authorities. According to the Canadian Institute of Health Information, hospital expenditures have been growing at between 7% and 10% annually since 1999. Assuming similar expenditure growth rates and no changes to the current hospital services programs, Hospital Services costs are expected to grow by $70 to $100 million in 2007-08 and by 7% to 10% in subsequent years.

In addition to the growth in hospital programs, Medicare costs have been growing at 8.8% per year over the past number of years resulting in an incremental cost of $30 to $40 million in 2007-08 and by 8.8% in subsequent years. Public expenditures for drug programs have increased nationally by approximately 10% to 11% in the last few years. Using this national trend, costs related to the prescription drug program are expected to increase by between $14 and $15 million in 2007-08 and by an additional 10% to 11% in the subsequent years.

Increases in costs related to Family and Community Services programs, excluding policy changes, have been approximately 1.5% annually and are expected to continue at this rate given the demographic trends.

A significant proportion of the remaining program expenditures relate to compensation costs. Typically, annual wage increases have been between $40 and $50 million a year.

1.6.2 New and Revised Programs

Tax and Other Revenue Programs

Over the past few years, a significant number of new tax measures have been introduced in New Brunswick. The net impact of these tax cuts has constrained revenues and will minimize growth over the next few years.

Equalization Programs

The Federal Equalization Program, which currently provides some 23% of total revenues for the Province, is under review. The net impacts of any changes to the Federal Equalization Program are not known, and thus the Province has budgeted prudently.

In its budget document, Restoring the Fiscal Balance[2], the Federal Government indicated its intention to enter into discussions with Provincial/Territorial governments about the equalization formula. These discussions are underway and the resulting changes to the equalization formula, and potentially other Federal Government grants and transfers to the Province, could have a material impact on the Province's fiscal projections.

Grants to the Maritime Province's Higher Education Commission

In 2005-06, the Province made an additional one time grant payment to the Maritime Province's Higher Education Commission (MPHEC). The 2006-07 grant was reduced. Assuming the annual grant commitment to the MPHEC is re-established in 2007-08, it will result in an incremental expenditure of $60 million over the forecast for 2006-07.

Tangible Capital Assets

Since the introduction of tangible capital asset accounting in April 2004, the Province's tangible capital asset acquisitions have exceeded amortization expenses by $340.8 million, resulting in incremental annual amortization charges of $6 to $8 million. A potential impact of an increasing asset base is the growth of amortization expense over time, reducing the Province's flexibility to make annual decisions about the allocation of fiscal resources.

The Province has entered into a contract to acquire the completed new section of the Trans-Canada Highway between Longs Creek and Grand Falls. This is expected to occur in

[2] http://www.fin.gc.ca/budget06/pdf/fp2006e.pdf

November 2007 at a maximum cost of $544 million, $135 million of which is expected to be funded by the Federal government. The annual amortization expenses related to this tangible capital asset are approximately $8 to $9 million annually.
In addition, the Province has entered into a memorandum of understanding with the Federal government to cost share an additional $400 million in road construction, half of which (the Provincial share) would be capitalized by the Province. While the specific terms have not been finalized, when completed this capital cost could result in approximately $3 million to $5 million in incremental amortization expenses annually.

NB Power

NB Power is intended to operate as a commercial enterprise. As such, it is expected to generate sufficient revenues and cash flows to fund its costs and financial obligations.

Under the Electricity Act, domestic rate increases in excess of 3% must be approved by the Public Utilities Board. In June 2006, the Public Utilities Board ruled NB Power could increase domestic power rates by an average of 9.6% effective August 1, 2006 based on NB Power's submission. Shortly thereafter, the Province reversed the PUB ruling and directed NB Power to cap its rate increase to 8%, which resulted in an average domestic power rate increase of 6.9%, effective July 1, 2006.

The result of the rate increase cap of 8% is a potential and perhaps on-going gap between NB Power's costs for generating and distributing power and the domestic and export revenues it is able to generate. Any income statement loss incurred by NB Power is reported through NB Electric Finance Corporation (NBEFC) in the Province's financial results, and therefore, has a negative impact on the Province's financial position. The projected annual loss for NBEFC at the time of the Province's decision to cap the rate increase at 8% was $46 million. This gap between actual costs and domestic power rates could result in both an income statement loss and potentially a cash deficit.

NB Power is planning a refurbishment of Point Lepreau beginning in fiscal 2007-08. The actual shut down is scheduled for an 18 month period beginning in April 2008. During the planned shut down and refurbishment of Point Lepreau, NB Power will be more heavily dependent on its thermal plants and hence fossil fuels for power generation. With the upward trend in fuel costs, the unpredictability of NB Power's operating results will increase.

The shut down will also severely limit NB Power's ability to export power. Export power sales have generally been more profitable than domestic power sales; therefore financial results could be negatively impacted.

It is estimated that the incremental operating costs associated with the shut down of Point Lepreau and the acquisition of alternate sources of power will result in annual operating losses of $140 million to $180 million during the period in which the shut down occurs.

Nursing Homes

Recently, three significant changes have been announced to nursing home funding policies: the elimination of the requirement for use of personal assets to fund nursing home stays, the introduction of a maximum per-diem rate based on room and board costs only and increases in the hours of daily care funded for nursing homes. As well government has committed to increasing the monthly comfort and clothing allowance to $200 in the future. In addition, the Province is in the midst of approving a capital improvement program totalling approximately $120 million for 12 nursing homes.

The annualized costs of the funding policy changes is expected to be $30 to $40 million annually and the costs related to construction that will be funded by the Province are expected to be an incremental $14 million to $15 million annually by 2009-10.

The resulting net expenditure pressures, over and above the current year forecast, are shown below. These amounts do not include incremental public debt charges related to funding these net expenditure pressures.

	2007-08	***2008-09***	***2009-10***
Hospital Services costs typically increase by 7-10% annually	$70 - $100	$145 - $210	$230 - $341
Medicare costs have been growing in New Brunswick at an average of 8.8% per year	$30 - $40	$65 - $85	$100 - $130
Prescription drugs spending has grown nationally at between 10% and 11%	$14 - $15	$29 - $32	$46 - $51
Family and Community Services Program costs excluding policy changes increase at 1.5% annually	$12 - $13	$24 - $27	$37 - $41
Wage increases have typically been $40-$50 million annually	$40 - $50	$80 - $100	$120 - $150
Estimated tax revenue growth before tax reductions	($80 - $90)	($180-$210)	($300-$330)
Estimated value of announced tax reductions	$80 - $90	$100 - $110	$140 - $150
Changes to Federal Equalization Formula will also result in minimal revenue growth	-	($30 - $50)	($60 - $100)
Anticipated reductions to Federal Conditional Grants	$30 - $35	$45 - $50	$60 - $65
Reinstatement of Grant to Maritime Provinces Higher Education Commission	$60	$60	$60

Amortization of the $409 million section of the Trans-Canada Highway	$8 - $9	$8 - $9	$8 - $9
The impact of the 8% rate increase cap for NB Power could cause an annual loss	$0 - $46	$0 - $46	$0 - $46
Acquisition of alternate sources of power during the Point Lepreau shut down	-	$140 - $180	$70 - $90
Funding policy changes for nursing homes will result in incremental costs	$30 - $40	$50 - $55	$50 - $55
Funding for nursing homes construction projects will result in incremental costs	$6 - $8	$12 - $15	$12 - $15
Total Net Expenditure Pressure	**$300 - $416**	**$548 - $719**	**$573 - $773**

1.6.3 Accounting Interpretations and Actuarial Valuations

Over the past few years, the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants has updated its guidance for a number of issues related to the presentation of government financial statements and the accounting for various transactions and amounts. The interpretation of this guidance is the responsibility of the Province. The Auditor General reviews these interpretations as part of the annual financial statement audit and to this point, has agreed with the Province's interpretation of these guidelines.

Based on recent decisions by Government, it is possible that, for future years, the interpretation of PSAB guidance might be revised, specifically related to the basis for consolidation of NB Power and Nursing Homes.

Basis for Consolidation of NB Power

A Government Business Enterprise is an organization that is legally separate, has delegated authority to carry out financial and operational matters, is principally intended to sell goods and/or services outside the Government Reporting Entity and has the ability to be self-sustaining. Accordingly, New Brunswick Electric Finance Corporation is considered to be a Government Business Enterprise for the purposes of consolidation onto the Province's financial statements. Therefore, the net results from NB Power are consolidated through NBEFC onto the revenue section of the Province's Statement of Operations (modified equity basis accounting).

Should NB Power cease to be self-sustaining, it may no longer be considered to be a Government Business Enterprise in the Province's Government Reporting Entity. The decision of the Province to reverse and revise the decision of the PUB, which is intended to provide decisions about the reasonableness of proposed power rate increases at arms-length from the Province, might impair NB Power's ability to be self-sustaining.

If NB Power were no longer considered to be a Government Business Enterprise, the current modified equity basis for accounting for NB Power in the Province's financial statements may need to be changed. This change could result in a requirement to fully consolidate the net results and the assets and liabilities of NB Power onto the Province's financial statements. This would increase the Province's funded debt.

Basis for Consolidation of Nursing Homes

Changes to funding polices and the approval of 12 capital projects will increase the proportion of funding that nursing homes receive from the Province from 65% to 85%. As a result, nursing homes are becoming increasingly financially reliant on the Province. In addition, approximately half of the province's nursing homes have accumulated operating deficits which are not a Provincial liability but do place pressure on government funding sources.

Currently, the Province has determined that nursing homes are not part of the Government Reporting Entity because they are not controlled by the Province. PSAB 1300.18 identifies the following indicators that provide evidence that control might exist:

- government has the power to unilaterally appoint or remove a majority of the members of the governing body of the organization;
- government has ongoing access to the assets of the organization, has the ability to direct the ongoing use of those assets, or has ongoing responsibility for losses;
- government holds the majority of the voting shares or a "golden share" that confers the power to govern the financial and operating policies of the organization; and
- government has the unilateral power to dissolve the organization and thereby access its assets and become responsible for its obligations.

PSAB 1300.19 identifies the following other indicators that may provide evidence that control exists:

When the government has the power to:

- provide significant input into the appointment of members of the governing body of the organization by appointing a majority of those members from a list of nominees provided by others or being otherwise involved in the appointment or removal of a significant number of members;
- appoint or remove the CEO or other key personnel;
- establish or amend the mission or mandate of the organization;
- approve the business plans or budgets for the organization and require amendments, either on a net or line-by-line basis;
- establish borrowing or investment limits or restrict the organization's investments;

- restrict the revenue-generating capacity of the organization, notably the sources of revenue; and
- establish or amend the policies that the organization uses to manage, such as those relating to accounting, personnel, compensation, collective bargaining or deployment of resources.

PSAB 1300.24 provides further clarification that is relevant to the issue of government's control of nursing homes and says:
"An organization's financial dependence on the government, in and of itself, does not constitute control. While financial dependence would usually give rise to a relationship based on influence, it is unlikely that financial dependence alone would enable the government to control an organization. The governing body of that organization may make independent decisions on its financial and operating policies. A government may require the organization to submit reports to demonstrate compliance with the terms and conditions of funding. These reports are not considered evidence of control because the government's interest in the organization extends only to the funding aspects of operations. For example, a private sector day care service that receives government funding may be required to demonstrate compliance with the terms and conditions of government funding. However, the governing body retains discretion as to whether it will take funding from, or do business with, the government."

Accordingly, the Province will have to monitor whether the changes to funding policy that give rise to these changes in proportional funding constitute a change in the Province's judgement as to whether government controls nursing homes. Should the Province determine that it has control of nursing homes, it would be required to recognize nursing homes as part of the government reporting entity and this could have significant implications for the liabilities and future fiscal results of the Province.

Completeness of the Government Reporting Entity

Any future changes to the composition of the Government Reporting Entity could impact the pension expense and liability positions (to the extent that any new reporting units to be included have pension plans encompassed by PSAB Section 3250).

Pension Valuations

The Province uses a prudent, disciplined approach to pension plan funding, supported by an underlying infrastructure of funding policies, practices and legislation.

The following trends related to the Province's pension plans could have an impact on the future fiscal requirements related to funding pension plans.

Longer life expectancy	Actuarial valuations have indicated recent trends regarding longer life expectancy which could increase pension liabilities. This impact has been offset somewhat by gains on pension assets as a result of market fluctuations in recently performed valuations related to the Province's pension plans.
Interest	An interest rate is applicable to the pension liability and assets in determining pension expense. A lower interest rate has been emerging in more recent actuarial valuations. These lower interest rates are serving to decrease the interest component of pension expense.
Modifications or improvements to plans	There have been no significant plan modifications or improvements within the last 10 to 12 years, which has assisted in ensuring adequate funding is in place for existing obligations. If future contract negotiations result in changes to the benefit entitlements or membership of pensions, these changes could have a material impact on the Province's fiscal results related to pension plans.
Early retirements	A number of pension plans are experiencing early retirements, which result in a plan loss if the employee retires ahead of expectations.
Special payments	Special payments will continue as long as there is an unfunded liability in the legislated pension plans.

1.7 Fiscal Responsibility and Balanced Budget Act

The Fiscal Responsibility and Balanced Budget Act indicates that it is the objective of the government that total expenses not exceed total revenues for the period commencing April 1, 2004 and ending March 31, 2007. Despite the negative forecast change to the deficit for 2006-07, the Province would remain in compliance with the legislation having a total actual and forecast surplus of $464.8 million over this period (2004-05 $242.2 million surplus, 2005-06 $240.2 million surplus and 2006-07 forecast $17.6 million deficit).

Financial forecasts however are based on assumptions about future events and circumstances, and actual events and circumstances may vary from these assumptions. As a result, the actual fiscal results and financial position of the Province at March 31, 2007 may vary from the forecast position provided in this report. The Province will therefore need to monitor its actual fiscal results against the requirements of the Fiscal Responsibility and Balanced Budget Act.

Given the implications beyond 2006-07 for the Province's fiscal results and financial position, it is important for the Province to develop plans that create fiscal results that are consistent with the objectives outlined in the legislation.

The Fiscal Responsibility and Balanced Budget Act also indicates that it is the objective of the government that, at the end of each fiscal period, the ratio of net debt to GDP will be less than at the end of the previous fiscal period.

Given the increase forecasted in net debt reflected in the Main Estimates, it is important for the Province to consider the forecast ratio of net debt to GDP for 2006-07 to ensure compliance with the legislation.

1.8 Recommendations

1 The Province should ensure that an effective collection system for default student loan accounts is put in place as soon as possible to minimize future student loan losses.

2 Tangible Capital Asset Accounting Review

To review, comment and make recommendations regarding the Province's adoption of the Canadian Institute of Chartered Accountants (CICA) Public Sector Accounting Board (PSAB) accounting for Tangible Capital Assets and the future implications of this approach with respect to Net Debt and debt obligations.

2.1 Procedures

Based on information from discussions with Provincial representatives and a review of documents provided by the Province, Grant Thornton LLP:

- documented the Province's current policy for Tangible Capital Asset (TCA) accounting;
- documented the fiscal implications of having adopted TCA accounting in fiscal 2004-05, 2005-06 and 2006-07;
- documented the expected actual spending related to capital assets in 2006-07 and the impact of this expected actual spending on the Province's fiscal results;
- commented on the Province's Tangible Capital Asset policy; and
- commented on the Government's policies with respect to budgeting for and managing Tangible Capital Assets.

2.2 Background

2.2.1 Tangible Capital Assets Defined

Tangible capital assets are items of a physical nature where the expected benefit to be realized from acquisition of these items is beyond one year. Typical government Tangible Capital Assets include roads, bridges, schools, hospitals and equipment.

2.2.2 Accounting Policy for Tangible Capital Assets

Prior to April 1, 2004, Tangible Capital Assets were recorded on the Province's financial statements as expenditures as they were acquired. As a result, the Province's net debt changed by the same amount as the actual tangible capital asset acquisitions in any given year.

In 2002 the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) adopted new accounting standards for Tangible Capital Assets effective for fiscal years beginning on or after April 1, 2005. The Province adopted the new accounting standards in its March 31, 2005 financial statements, one year earlier than required.

The new accounting standards for Tangible Capital Assets require tangible capital asset acquisitions be recorded on the Province's financial statements as non-financial assets rather than expenditures. Non-financial assets are, in turn, written off through amortization expenses, over the estimated useful life of the related tangible capital asset. The Province has established various thresholds to define tangible capital assets.

The impact of the introduction of this new accounting policy for Tangible Capital Assets is that, because amortization expenses do not match net acquisitions of capital assets, the change in the Province's net debt is no longer equal to the Province's annual surplus or deficit.

Table 2-1 below shows the difference between the amortization expenses and acquisition costs for the Province since the new accounting policy was implemented.

Table 2-1 Differences Between Acquisition Costs and Amortization Expenditures

(in millions of dollars)

Tangible Capital Assets Transactions	**2004-05 Actual**	**2005-06 Actual**	**2006-07 Main Estimates**	**2006-07 Forecast**
Acquisitions				
Acquisitions	$ (326.7)	$ (342.2)	$ (345.9)	$ (366.5)
Less: Revenue received to acquire tangible capital assets	34.3	24.9	27.6	28.2
Net Acquisitions	(292.4)	(317.3)	(318.3)	(338.3)
Amortization				
Amortization Expenses	(193.4)	(204.5)	(209.1)	(206.6)
Less: Losses on Sales of Tangible Capital Assets	(2.3)	(0.4)	-	-
Net Amortization	(195.7)	(204.9)	(209.1)	(206.6)
Difference Between Acquisitions and Amortization	**$ (96.7)**	**$ (112.4)**	**$ (109.2)**	**$ (131.7)**

Under the former accounting policy, where the annual surplus or deficit of the Province was essentially equivalent to the change in net debt, the Province's financial performance was primarily discussed in terms of its surplus or deficit. Because the new accounting policy for Tangible Capital Assets creates a difference between the surplus or deficit and the change in net debt, it is now important to consider both measures in assessing the financial performance of the Province.

Table 2-2 shows a restatement of the Province's surplus or deficit to demonstrate the impact of the actual differences between amortization expenses and acquisition costs. Since the introduction of the new TCA accounting policy at April 1, 2004, the net debt is forecast to have decreased by only $120 million (decreases in net debt of $145.5 in 2004-05 and $131.2 million in 2005-06 less forecast increase in net debt of $156.7 million in 2006-07) compared with the forecasted accumulated surplus of $468.2 million (surpluses of $242.2 million in 2004-05 and $243.6 million in 2005-06 less forecast deficit of $17.6 million in 2006-07) for the same period.

Table 2-2 Restatement of Surplus (Deficit)

(in thousands of dollars)

	2004-05 Actual	2005-06 Actual	2006-07 Estimate	2006-07 Forecast
Surplus(Deficit)	**$ 242.2**	**$ 243.6**	**$ 22.2**	**$ (17.6)**
Reverse Amortization Expenditures				
Amortization of Tangible Capital Assets	193.4	204.5	209.1	206.6
Losses on Sales of Tangible Capital Assets	2.3	0.4	0	0
Add Acquisitions				
Acquisitions of Tangible Capital Assets	(326.7)	(342.2)	(345.9)	(366.5)
Revenue Received to Acquire Tangible Capital Assets	34.3	24.9	27.6	28.2
Surplus (Deficit) Restated for TCA	**$ 145.5**	**$ 131.2**	**$ (87.0)**	**$ (149.3)**
Adjustment for Prepaid Expenses				(7.4)
Decrease (Increase) to Net Debt	**$ 145.5**	**$ 131.2**	**$ (87.0)**	**$ (156.7)**

2.2.4 Budgeting and Managing Tangible Capital Assets

The Province budgets for acquisitions of Tangible Capital Assets as part of its annual budget process. Accordingly, the 2006-07 Main Estimates include an estimate related to:

- total acquisitions;
- total amortization expenses; and
- revenues received to acquire Tangible Capital Assets.

The Estimates related to Tangible Capital Assets are included in the estimates of the respective Departments who have management responsibility for Tangible Capital Assets.

Based on the PSAB standards for TCA accounting, the Province has adopted a TCA policy which defines the basis for identifying a tangible capital asset, the thresholds to apply in considering whether or not an acquisition is a tangible capital asset, the amortization rates (estimated useful life) to be applied to different classes of Tangible Capital Assets, and other tangible capital asset considerations. The TCA policy is applied across Government Departments.

2.3 Forecast 2006-07

As shown in Table 2-3, the Province is forecasting actual tangible capital asset acquisitions will exceed the Budget of $346 million[3] in the 2006-07 Main Estimates by $21.0 million.

Forecast expenses related to amortization are $2 million less than the amount provided for amortization expenses in the 2006-07 Main Estimates.

Table 2-3 Expected Fiscal Results Related to Tangible Capital Assets

(in thousands of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Acquisitions of Tangible Capital Assets	$ (342)	$ (346)	$ (367)	$ 21
Amortization of Tangible Capital Assets	$ 205	$ 209	$ 207	$ 2
Revenue received to acquire Tangible Capital Assets	$ 25	$ 28	$ 28	$ 0

2.4 Material Variances from Main Estimates

Outlined below is an explanation of material variances between the amounts included in the 2006-07 Main Estimates for capital acquisitions and forecast capital acquisitions costs.

Health construction projects in the Department of Supply & Services.	$8.6m
Education capital improvement projects in the Department of Supply and Services.	$3.5m
Permanent highway improvements concerning a variety of projects as well as the Hanwell Road interchange completion in 2006-07 instead of 2007-08 and other increased costs for transportation capital projects related to increased fuel prices and asphalt prices.	$7.2m

The accounting policy for Tangible Capital Assets requires only the amortization expenses related to Tangible Capital Assets be included in the calculation of surplus or deficit.

[3] This amount is shown net of current year amortization expenses related to capital acquisitions made in 2006-07.

2.5 Risks and Uncertainties related to the 2006-07 Forecast

Financial forecasts are based on assumptions about future events and circumstances and actual events and circumstances may vary from these assumptions. As a result, the actual fiscal results and financial position of the Province at March 31, 2007 may vary from the forecast position provided in this report.

There are no significant known risks or uncertainties expected to impact the forecast for 2006-07 related to tangible capital asset acquisitions or the calculation of amortization expenditures.

2.6 Implications beyond 2006-07

2.6.1 Acquisitions Exceed Amortization

In New Brunswick the actual and forecasted acquisition of assets has exceeded the actual and forecast amortization expenses by $340.8 million in the three years since the new TCA accounting policy has been in place, as shown in Table 2-1. A potential impact of an increasing asset base is the growth of amortization expenses over time, reducing the Province's flexibility to make annual decisions about the allocation of fiscal resources. For example, assuming an average estimated useful life of 40 years, the incremental $340.8 million in actual and forecast tangible capital asset acquisitions over amortization expenses would result in an incremental annual amortization expense requirement of $8.7 million.

2.6.2 Trans-Canada Highway (Longs Creek to Grand Falls)

In fiscal 2007-08, the section of the Trans-Canada Highway (Longs Creek to Grand Falls) currently under construction will be acquired by the Province for an estimated cost of $544 million, $135 million of which is expected to be funded by the Federal government. This acquisition will increase the Province's net debt by this amount. In the 2005-06 Public accounts, the Province's total net debt was estimated to be $6,655.7 million at the end of March, 2006. An increase of approximately $409 million for this new section of highway represents a 6% increase in net debt and, assuming a 45 to 50 year amortization rate, represents an annual increase in amortization expense of $8 million to $9 million.

2.6.3 Canada-New Brunswick Highway Improvement Agreement

In addition, the Province recently entered into a Memorandum of Understanding with the Federal Government to cost share in an additional $400 million in road construction. The terms and timing of this construction are yet to be determined but, when complete, the additional $200 million in capital costs would result in an incremental annual amortization expense of approximately $3 million to $5 million.

2.6.4 Amortization Rates

The PSAB guidelines related to TCA accounting do not provide specific guidance with respect to amortization rates, eligible capital thresholds and asset classifications, but instead allow each organization to determine these definitions based on their own specific circumstances and professional judgment. As a result, practices and polices vary between provinces and, to some extent, across the New Brunswick Government Reporting Entity.

Because TCA accounting is a relatively new practice for governments, there is not a significant historical basis from which to identify appropriate estimated useful lives for assets or amortization periods. Actual experience may prove the estimated useful life that has been used to establish amortization periods may not be appropriate.

The following table provides a comparison of the capital thresholds and amortization rates adopted by Nova Scotia and Prince Edward Island for comparison purposes.

Table 2-4 Comparison of Capital Thresholds and Amortization Rates[4]

(in units of dollars)

ASSET	THRESHOLD AND AMORTIZATION (Years or % per Year)		
	Nova Scotia	**New Brunswick**	**Prince Edward Island**
Land	N/A	N/A	N/A
Land Improvements and Towers	N/A	$100,000 20 Years	
Buildings	$250,000 5%	$100,000 40 Years	$75,000 40 Years
Building Improvements	$150,000 5%	$100,000 20 Years	$75,000 10 Years
Leasehold Improvements	$250,000 Lease Term	$100,000 Lease Term	$75,000 Lease Term
Schools	(Same as Buildings)	(Same as Buildings)	(Same as Buildings)
Portable Classrooms	$50,000 30%	$100,000 25 Years	(Same as Buildings)
Ferries, Landings and Wharves	$250,000 5%	$100,000 40 Years	$75,000
Major Equipment	$50,000 20%	$100,000 5-15 Years	$75,000 5 Years
Computer Hardware	$25,000 50%	N/A	$75,000 5 Years
Computer Software	$250,000 25%	N/A	$75,000 5 Years
Roads / Highways:			
Construction	$500,000* 5%	$100,000 50 Years	$75,000 20 Years
Resurfacing	$500,000 15%	$100,000 20 Years	$75,000 10 Years
New Structures	$500,000 5%	$100,000 50 Years	$75,000 40 Years
Replacement Structures	$250,000 5%	$100,000 50 Years	$75,000 20 Years
Light Motor Vehicles	$15,000 35%	$15,000 5-10 Years	$20,000 5 Years

* A combined threshold of $500,000 for substructure, pavement and bridges

[4] CICA Discussion Paper Series – Accounting for Tangible Capital Assets, June 2006

2.6.5 Age of the Asset Base

When the Province introduced the new TCA accounting policy, it was encouraged to estimate the net book value of existing assets and to categorize these assets by asset class for the purposes of assigning an amortization rate to the asset class. Given the limitations on available information related to Tangible Capital Assets, it was difficult for the Province to estimate the average age of the assets in any particular asset class. The actual age of the Province's assets, and therefore their remaining useful lives, may be greater or less than the estimate used to establish amortization rates.

2.6.6 Increasing Debt Charges

As shown in Table 2-2, in the first two years of the new accounting policy for Tangible Capital Assets, net debt decreased significantly. This decrease in net debt was offset to some degree by the extent to which acquisition costs exceeded amortization expense.

The budgeted acquisitions for Tangible Capital Assets in the 2006-07 Main Estimates will result in an increase in net debt which in turn could result in an increase in debt servicing charges. A continued trend to acquire assets in excess of annual amortization expense may result in a continued increase in net debt and commensurate increases in debt servicing charges.

Currently, the Province does not have a long-term capital asset acquisition or management plan placing limitations on or providing guidance to annual budgeting for capital acquisitions to ensure net debt related to capital acquisitions does not increase beyond planned levels to a point that would impair the Province's overall fiscal results.

2.6.7 Future Changes to Accounting Guidelines

PSAB continues to issue updates to accounting guidelines related to Tangible Capital Assets. The most recently issued update in September 2006 provides guidance on the disclosure of information related to Tangible Capital Assets and is not expected to have any material impact on the Province's current accounting treatment for Tangible Capital Assets. However, compliance with this guideline may require a significant investment of personnel resources to adequately address the reporting requirements.

In August 2006, PSAB released an exposure draft on Government Transfers. This exposure draft, if adopted, will require government transfers related to capital, such as those received from the Federal Government, to be accounted for as revenue in the year of receipt. This is a significant conceptual change from the present practice of netting capital transfers received against the related asset to result in amortization of the asset on a net basis.

This matter is a topic of controversy in the accounting profession and is subject to further revisions based on feedback from the accounting community. Feedback was due to the CICA by September 30, 2006 but has not yet been released publicly.

It is expected standards for TCA accounting will continue to evolve and should be monitored on an ongoing basis to ensure the Province will be in a position to comply, budget and report accordingly.

2.7 Recommendations

2 The Province should consider developing a long-term capital acquisition or management plan to provide guidance on annual capital acquisitions and to ensure changes to net debt related to capital acquisitions do not exceed planned levels.

3 The Province should review the current TCA accounting policies of all entities within the Government Reporting Entity and assess the reasonableness and consistency of amortization rates, capital thresholds and identified asset classes.

4 The Province should evaluate the appropriateness of its amortization rates and capitalization thresholds based on a reasonable period of actual experience and based on the experience of other comparable provinces. This review should consider whether amortization rates appropriately reflect the useful life of the Province's assets and if the corresponding amortization expenses appropriately reflect the consumption of assets in the delivery of services.

5 The Province should continue to monitor evolving guidance from PSAB with respect to TCA accounting to allow it to plan and manage Tangible Capital Assets appropriately.

3 Future Obligations Including the Contract for the Twinning of Trans-Canada Highway (Longs Creek to Grand Falls)

To review, comment and make recommendations regarding an estimate of the Province's future obligations including the twinning of the Trans-Canada Highway (Longs Creek to Grand Falls).

3.1 Procedures

Based on information from discussions with Provincial representatives and a review of documents provided by the Province, Grant Thornton LLP:

- reviewed and documented the financial arrangements and accounting issues arising from the Trans-Canada Highway projects, including both the design/construction and the operation/maintenance and rehabilitation contract;
- reviewed and documented the financial arrangements and accounting issues arising from the contract terms for the remaining term of the operation / maintenance / management contract for the Fredericton to Moncton Highway;
- reviewed and documented the financial arrangements and commitments relating to the Canada-New Brunswick Highway Improvement Agreement signed October 2, 2006;
- reviewed and documented the supplemental funding agreement for continuation of the Saint John to Digby ferry service;
- reviewed summary details related to capital projects managed by the Department of Supply & Services, to determine significant risks of project overages or accelerations which would require depreciation to be expensed prior to the time contemplated within the budget;
- met with senior staff of the Departments of Transportation, Finance and Supply & Services to assess financial risk areas and exposures;
- documented the planned accounting treatment for the financial obligations in the contracts reviewed;

- documented the projected financial impact of this accounting treatment on the Province's fiscal results by year, and the variables that could affect these expected fiscal results;
- documented risks related to the planned accounting treatment; and
- documented potential alternative accounting treatments and risks/benefits.

3.2 Overview

This review considered significant capital projects currently underway or committed by the Province. Specifically, this review considered:

- the Trans-Canada Highway (Longs Creek to Grand Falls) project;
- the Fredericton to Moncton Highway Contract;
- projects under the Canada- New Brunswick Highway Improvement agreement;
- the Saint John to Digby Ferry Development Agreement; and
- Department of Supply and Services Capital projects.

3.2.1 Trans-Canada Highway (Longs Creek to Grand Falls) Contracts

The Province has entered into two contracts with the Brun-Way Group Joint Venture (Brun-Way) – a design and build contract and an operation, maintenance and rehabilitation contract. Each of these is described below.

The first contract provides for the design and building of 98 kilometres of highway and the upgrading of an additional 128 kilometres of highway on Route 2, to be completed November 1, 2007.

It provides for a maximum payment, subject to scope changes or other limited factors, of $544 million, $135 million of which is expected to be funded by the Federal government.

The capital cost of the design and build component will be capitalized by the Province in accordance with its Tangible Capital Asset policy and amortized over 50 years when the Province takes ownership of the highway.

The Province has a number of means to monitor the quality and standards during the design build project. The ultimate means of monitoring results is the final inspection of the highway before acceptance by the Province and approval for traffic.

The second contract provides for the operation, maintenance and rehabilitation of 275 kilometres of highway on Routes 2 & 95. It provides for full maintenance of the highway, in accordance with a maintenance plan, to meet prescribed standards for the period to June 30, 2033.

Annual costs to the Province under this contract have been set, for the duration of the contract, for amounts which are indexed to the NB Consumer Price Index. These costs are expensed by the Province in conjunction with the timing of the payments to Brun-Way.

Throughout the operations and maintenance agreement term, Brun-Way (the Operator) is required to follow the terms of an agreed asset management plan, comply with environmental and safety standards, and respond to results of certain inspections. Upon the final transfer of responsibility from the operator to the Province, the highway must meet terms of required condition. If this condition is not attained, it is the Operator's responsibility to achieve appropriate status before transfer.

3.2.2 Fredericton to Moncton Highway Contract

The Fredericton to Moncton Highway contract provides for the operation, maintenance and management of the highway from Longs Creek to Moncton for the period of 30 years to 2027. The contract was executed with Maritime Road Development Corporation.

The operation, maintenance and management contract provides for full maintenance of the highway, in accordance with a maintenance plan, to meet prescribed standards for the period to 2027. Annual costs to the Province under this contract have been set for the first 20 years of the contract, for amounts which are indexed to the NB Consumer Price Index. These annual amounts fluctuate significantly during certain years. For example, the annual cost for 2007 is set at $7.9 million[5], whereas the annual cost for 2015 will be $23.8 million[6].

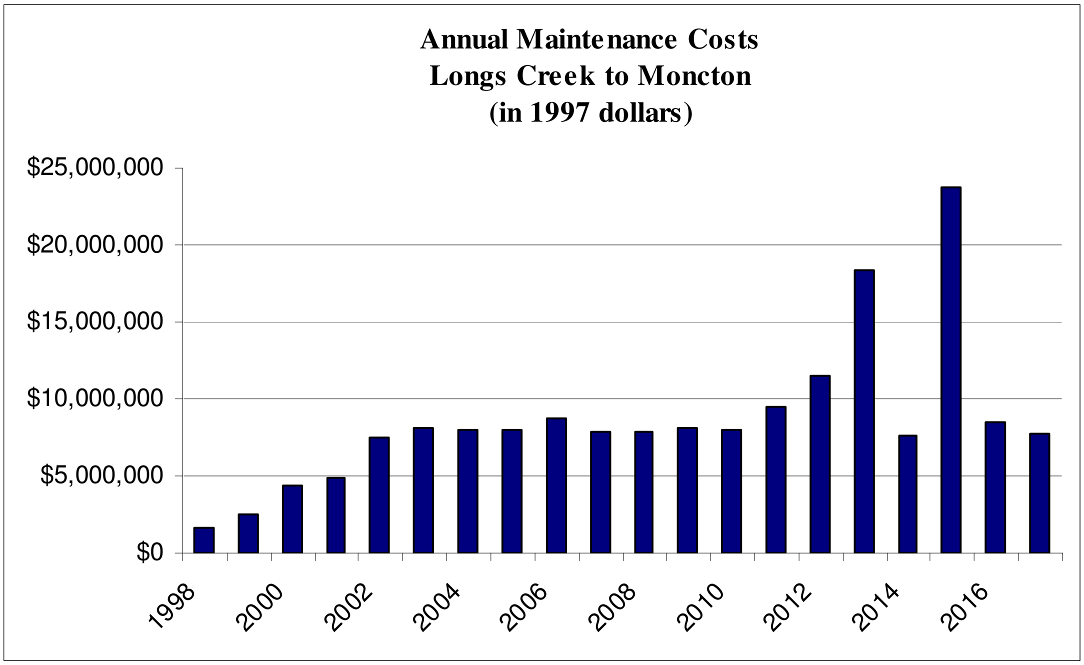
Operations and maintenance costs are expensed by the Province in conjunction with the timing of the annual payments. This has resulted in relatively stable growth in the pre-inflationary expense for the past ten years since the commencement of the contract, but will cause major variations in the reported expenditures of the Province on this stretch of highway over the next ten years.

The projected annual maintenance costs are shown in Figure 3-1 below.

[5] Before inflationary adjustment for the NB Consumer Price Index change since October 1997.

[6] Before inflationary adjustment for the NB Consumer Price Index change since October 1997.

Figure 3-1 Actual and Projected Annual Maintenance Costs associated with the Longs Creek to Moncton Highway (in units of dollars)



3.2.3 Canada – New Brunswick Highway Improvement Agreement

On October 2, 2006 then Premier Bernard Lord and Prime Minister Stephen Harper signed a memorandum of understanding whereby the governments of New Brunswick and Canada jointly committed $400 million to be spent over the next ten years to refurbish New Brunswick's highways. The Province's commitment amounts to $200 million of these funds.

The memorandum of understanding requires the two governments to negotiate a new highway improvement agreement, which shall be signed by March 31, 2007, for work to be undertaken in the 2007-2008 fiscal year through the 2016-2017 fiscal year.

At this point no formal commitments have been made in the memorandum of understanding as to which projects will be undertaken, or when. In addition, no construction contracts have been tendered to date with respect to this commitment.

3.2.4 Saint John to Digby Ferry Development Agreement

The Government of New Brunswick obtained approval from the Provincial Cabinet and an Order in Council to provide funding of up to $2 million to the operator of the Saint John to Digby Ferry Service to ensure continued operation of the service and exploration of a sustainable business model for future operations.

As of the date of this report, the agreement among the governments of Nova Scotia, New Brunswick and Canada and the operator has not been finalized.

3.2.5 Department of Supply and Services Capital Project Program

The Department of Supply and Services manages capital projects on behalf of various government departments. The Department of Supply and Services identified the following capital projects that they are currently managing where the individual project budget is in excess of $5 million.

Table 3-1 Project Budget for DSS projects over $5 million

		Project Cost		Expected
	Budget	Forecast	Variance	Completion
Bathurst School	$ 8,507,000	$ 8,408,000	$ (99,000)	2006 - 2007
Hartland School	12,529,000	12,988,000	459,000	2006 - 2007
Stan Cassidy Centre	28,600,000	29,300,000	700,000	2006 - 2007
Bathurst Hospital	11,528,000	13,983,000	2,455,000	2007 - 2008
Ecole Sam de Champlain	5,940,000	7,331,000	1,391,000	2007 - 2008
Moncton Hospital	41,000,000	47,542,000	6,542,000	2007 - 2008
Upper River Valley Hospital	79,050,000	83,661,000	4,611,000	2007 - 2008
Ecole Ste. Anne	11,900,000	15,343,000	3,443,000	2008 - 2009
	$199,054,000	$ 218,556,000	$ 19,502,000	

These projects become Tangible Capital Assets within the financial statements of the provincial government and eligible for amortization over the life of the asset as at the fiscal year when the project is substantially complete. This project schedule reflects nearly $219 million of committed new Tangible Capital Assets as of the 2008-2009 fiscal year.

3.3 Forecast 2006-07

The forecast related to capital assets is provided in Section 2 of this report along with an explanation of the material variances from Main Estimates.

3.4 Risks and Uncertainties related to the 2006-07 Forecast

Capital assets are amortized over a period of time representing the estimated useful life of the asset. As a result, there is little risk that any variances related to capital costs will materially change the forecasted amortization expenses.

If the final terms of the agreement related to the Digby to Saint John Ferry result in a liability in the current fiscal year, the forecast should increase by up to the $2 million commitment to reflect this.

3.5 Implications beyond 2006-07

3.5.1 Future Implications of the Trans-Canada Highway (Longs Creek to Grand Falls) Contracts

Within the terms of the design build contract, the majority of risk rests with the external contractor. The Province's risks relate to identification of archaeological or contaminated sites along the construction path, or environmental issues such as determination of sulphide bearing rock along the planned construction path. Senior Department of Transportation staff indicate that none of these items have been identified to date. The key remaining exposure is the risk of interest rate increases between now and the date the completion payment is made to Brun-Way.

The contract with Brun-Way provides for a maximum payment, subject to scope changes or other limited factors, of $544 million, $135 million of which is expected to be funded by the Federal government. The capital cost of the design and build component will be capitalized by the Province in accordance with its Tangible Capital Asset policy when the asset is acquired in November 2007 and will be amortized over 50 years. This will result in amortization expenses of $8 million to $9 million annually.

The terms of the operation and maintenance contract smooth the Province's cost of maintaining the highway. The contract provides an annual future expense which increases by the NB Consumer Price Index.

3.5.2 Future Implications of the Fredericton to Moncton Highway Contract

The terms of the operation and maintenance contract provide substantial fluctuations in the annual cost of maintenance throughout the remaining term of fixed pricing. In the absence of any normalization or basis for capitalization of the resurfacing components of these costs, these fluctuations will have significant impact on the Department of Transportation's annual budget in certain of the years to come.

3.5.3 Future Implications of the Canada – New Brunswick Highway Improvement Agreement

Until the highway improvement agreement has been signed, specific implications cannot be determined however, when the construction is complete and the Province's $200 million share of the assets are capitalized, the annual amortization expenses related to these assets will be approximately $3 million to $5 million annually.

3.5.4 Future Implications of the Department of Supply and Services Capital Projects

The Department of Supply and Services is currently managing nearly $170 million of major projects (over $5 million each) for targeted completion dates beyond 2006-2007. The actual costs of each of these projects will have a dollar for dollar impact on the Province's net debt level, but have limited impact on annual expenses, which will include the additional interest costs relating to the new debt taken on to finance these assets and the amortization of the capital cost over the life of the assets from their completion dates.

4 Cap on NB Power Rates

To review, comment and make recommendations regarding the current and future impact on the Province's fiscal situation as a result of the decision to cap electric power rate increases at 8% in the current year and what would result should this cap be continued in future years.

4.1 Procedures

Based on information from discussions with Provincial representatives and representatives of NB Power and a review of documents provided by the Province, Grant Thornton LLP:

- documented the financial relationship between NB Power and the Province and the resulting accounting treatment of NBEFC on the Province's financial statements;
- documented the governance model between NB Power and the Province;
- reviewed the Government's decision to cap rate increases at 8% and the conditions and terms applied to this cap;
- documented the estimated impact on the Province's fiscal results of the decision included in the Main Estimates 2006-07;
- quantified the expected impact on the Province's fiscal results based on the current forecast of expected net expenditures (loss);
- quantified the expected net expenditures for NBEFC for the next 3 years assuming the 8% rate increase cap remains in place, and the impact on the Province's fiscal results; and;
- commented on the financial risks related to introducing and maintaining a cap on increases in power rates, and financial risks related to the current governance models and financial relationships between the Province and NB Power.

4.2 Organization Structure

The Electricity Act was passed on October 1, 2004 to restructure the electricity market in New Brunswick as well as NB Power. This restructuring of NB Power was intended to:

- facilitate the conversion and partial reduction of NB Power's debt by transferring and allocating it to appropriate levels in the various new corporations; and
- separate financial management of assets, liabilities, rights and obligations from operations through the new corporate structure.

The Minister of Energy holds a Class A voting share in NB Power Holding Corporation (NBPHC). NBPHC holds all Class A voting shares in its four subsidiaries:

- NB Power Distribution and Customer Services Corporation
- NB Power Transmission Corporation
- NB Power Nuclear Corporation
- NB Power Generation Corporation

NB Power Generation Corporation holds all Class A voting shares in the following two companies:

- NB Power Coleson Cove Corporation
- NB Coal Ltd

NBPHC and its subsidiaries, along with the two subsidiaries of NB Power Generation Corporation, are commonly known as NB Power Group or NB Power. NBPHC's combined financial statements reflect the results of the NB Power Group.

A separate company, NB Electric Finance Corporation (NBEFC), was created to facilitate the conversion of NBPHC debt to appropriate levels of debt in the subsidiaries of the Corporation and to assume and reduce the remaining portion of the Corporation's debt and to manage the assets, liabilities, rights and obligations of the NBEFC received as part of the restructuring. The Province, represented by the Minister of Finance, is the sole shareholder of this corporation. NBEFC holds Class B non-voting shares of NBPHC and its subsidiaries including Coleson Cove. NBEFC reports the financial results (income or loss) of NB Power on its financial statements on a equity basis.

NBEFC provides one entity in which all debt management functions associated with the restructuring of NB Power reside. It manages the debt assumed in the restructuring of NB Power and manages any new debt acquired by NB Power Group. NBEFC generates the required funds for these debt payments through the receipt of interest and principal payments, special payments and dividends from the NB Power. Specifically, NBEFC receives the following cash flows from NB Power:

- Payments in lieu of taxes (PILs) based upon the financial results of the NB Power Group;
- Debt portfolio management fee;
- Interest on all funds or loans to the NB Power; and
- Dividends as declared.

NBEFC receives the capital to provide financing to NB Power Group through loans (debentures) from the Province. The Province borrows funds on an ongoing basis from various bond markets. The Province ultimately reports the results of NB Power by reflecting the net earnings and financial position of NBEFC in its financial statements using the modified equity basis of accounting. That is, the net results for NBEFC are shown as one entry in the revenue section of the Province's Statement of Operations. The Statements of Financial Position (balance sheets) related to NBEFC and NB Power are not consolidated with the Province's Statement of Financial Position.

Table 4-1 provides an overview of the key financial transactions between NB Power, NBEFC and the Province.

TABLE 4-1 Forecast 2006-07 for Various Amounts related to NB Power

(in millions of dollars)

	2004-05 Actual	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast
NBEFC Income (Loss)	$ 1.34	$ 128.31	$ (46.00)	$ 1.00
NBEFC PILs from NB Power	15.79	60.13		27.00
NBEFC Debt Portfolio Management Fee from NB Power	10.09	20.32		20.16
Interest received from NB Power	99.28	196.60		187.74
Total NB Power Debt financed by NBEFC	3,155.28	3,129.59		3,068.00
Dividends declared by NB Power	4.80	12.00		-

4.3 Governance and Financial Relationship between the Province and NB Power

The governance relationship between the Province, NB Power and NBEFC is defined through the enabling legislation. The Deputy Minister of Finance serves as President of NBEFC, and the Province appoints the Directors of NBEFC.

The governance relationship is further defined through shareholders' agreements between the Province, NBEFC and each of the companies in the NB Power Group, dated October 1, 2004. The agreements set out duties and obligations of the respective parties and the boards.

The agreements indicate the Province and/or NBEFC have the ability to exercise significant influence in major governance decisions of NB Power and allow the Province access to extensive financial and operational information on demand. Other examples of the issues on which the Province and/or NBEFC can exercise significant influences include:

- issuance of shares;
- approval of by-laws;
- payment of benefits;
- appointment of chair of Board of Directors;
- appointment of President and Chief Executive Officer;
- appointment of auditors; and
- payment of dividends.

The shareholder agreements require each company in the NB Power Group to prepare an annual strategic business plan and budget for submission for review by the Board of NBEFC. NBEFC does not approve the annual reports and budgets. At a minimum, NBPHC is also required to provide the following financial/operational reports to the Province and NBEFC:

- President's report to the Board of Directors from time to time;
- minutes of the meetings of the Board of Directors;
- quarterly financial statements;
- corporate management reports;
- monthly financial statements and reports;
- monthly operating results report;
- reports on cash flow/liquidity;
- report on load and resources adequacy (where applicable); and
- annual report.

4.4 NB Power Business Model

The financial results of NB Power are primarily determined by three key variables:

- revenues generated from domestic sales of power;
- revenues generated from export sales of power; and
- costs related to producing and distributing this power.

The actual costs of generating and distributing power are intended to be the basis for establishing the domestic rates (or prices) for power. Under the Electricity Act, NB Power is permitted to increase domestic rates by up to 3% or CPI annually, whichever is greater, at its discretion. Domestic rate increases in excess of 3% or CPI must be approved by the Board of Commissioners of Public Utilities of New Brunswick (PUB).

Domestic consumption of power is influenced by a number of factors but, most significantly, temperatures and industrial activity.
Prices for exported power are based on market conditions.

Costs related to producing and distributing power are influenced by a number of variables, most significantly fuel prices, weather conditions and domestic demand.

4.5 Rate Increase and Cap

For a 13 year period, NB Power managed costs and revenues from export power sales to maintain domestic power rate increases at 3% or less.

On March 21, 2005, NB Power Distribution and Customer Service Corporation submitted an application to the PUB to increase power rates by an average of 11.6% for 2006-07 to address the significant increases in power supply costs impacted by fuel cost increases.

After extensive hearings, PUB issued its decision on power rates on June 19, 2006, allowing NB Power an average rate increase of 9.6%, effective August 1, 2006.

On June 23, 2006, the Province issued Order in Council 2006-242, in which the PUB decision was modified and reversed and revised rates were established. These revised rates essentially had the effect of "capping" the increase in domestic power rates to an average of 8% for 2006-07, which resulted in an average domestic power rate increase of 6.9%, effective July 1, 2006.

Because NB Power's financial results are based on the domestic and export revenue it generates less the costs of producing and distributing power, the cap on domestic power rates essentially limited one of these three key determinants of NB Power's financial results.

Based on government's announcement of a rate increase cap of 8%, the Province estimated NBEFC's loss for 2006-07 to be $46 million. Accordingly the Province included a loss in 2006-07 of $46 million related to NBEFC in the Main Estimates.

4.6 Forecast 2006-07

TABLE 4-2 Forecast 2006-07 related to NB Power

(in millions of dollars)

	2005-06 Acutal	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
NBEFC Income	$ 128.31	$ (46.0)	$ 1.0	$ 47.0

4.7 Material Variances from Main Estimates

Higher than average hydro conditions and improved exports, amongst other factors, have resulted in a forecast $1 million net income from NBEFC which has a relatively positive impact on the forecast financial position of the Province for 2006-07 as compared with the estimated loss of $46 million at the time the Main Estimates were prepared.

4.8 Forecast 2006-07 Risks/Uncertainties

Financial forecasts are based on assumptions about future events and circumstances, and actual events and circumstances may vary from these assumptions. As a result, the actual fiscal results and financial position of the Province at March 31, 2007 may vary from the forecast position provided in this report.

Known factors that could impact the 2006-07 forecast for net income for NB Power include:

- hydro conditions varying from long-term averages;
- recent increases (volatility) in fuel prices and possible availability issues;
- unpredictability of weather and hence demand for power;
- demand and price sensitivity of foreign markets; and
- demand for energy by major customers.

4.9 Implications beyond 2006-07

4.9.1 Projected Fiscal Results

The result of the rate increase cap of 8% is a potential and perhaps on-going gap between NB Power's costs for generating and distributing power and the domestic and export revenues it is able to generate. The projected annual loss for NBEFC at the time of the Province's decision to cap the rate increase at 8% was $46 million. This gap between actual costs and domestic power rates could result in both an income statement loss and potentially a cash deficit. Any income statement loss incurred by NB Power is reported through NBEFC in the

Province's financial results, and therefore, has a negative impact on the Province's financial position.

NB Power's business plan at the time that the 11.6% rate increase was requested anticipated 3% domestic power rate increases in 2007-08 and forward. Based on this assumption, NBEFC was projecting break-even results for 2007-08 and a $181 million loss in 2008-09 as a result of the anticipated Point Lepreau shutdown.

These projected results could also be impacted based on changes to any of the key assumptions outlined below on which the original projections were based.

Completion of international power line	NB Power's business plan anticipates the completion of the second international power line by December, 2007.
Refurbishment of Point Lepreau	During the planned shut down and refurbishment of Point Lepreau, NB Power will be more heavily dependent on its thermal plants and hence fossil fuels for power generation. With the upward trend in fuel costs, the unpredictability of NB Power's operating results increases. Also, the shutdown will severely limit NB Power's ability to export power. Export power sales provide significant contribution margins against the fixed costs borne by domestic ratepayers. Without these contributions, financial results will suffer.
Changes to overall project planning and timing of the Point Lepreau refurbishment project	Changes in the timing of the planned shut down and refurbishment of Point Lepreau and/or actual progress on the refurbishment project may have material implications on NB Power's financial results.

4.9.2 Increased Borrowing

The decision to cap domestic power rate increases at 8% constrains one of the three key determinants of NB Power's financial results – domestic revenue. This creates a potential gap between the cost of producing and distributing domestic power and the domestic rate for power (the difference between the 11.6% requested average increase in domestic rates and the government-directed maximum 8% increase). This estimated gap was expected to result in a $67 million loss of revenue for NB Power for 2006-07 and an estimated net loss of $46 million overall for NBEFC.

Should circumstances in the future result in NB Power being unable to bridge the gap between the cost of producing and distributing domestic power and the domestic rate for power through cost reductions and/or incremental revenues from export power sales, NB Power will incur a loss. In a loss situation, NB Power will potentially be unable to meet all of its cash obligations related to debt payments to NBEFC.

NBEFC's single revenue stream is from NB Power and NBEFC does not have any accumulated cash reserves from which to fund any cash deficits that might result from NB Power operating in a cash deficit position. If NB Power were not able to meet all of its cash obligations to NBEFC, NBEFC would not be able to meet all of its repayment obligations to the Province. This situation would essentially require the Province to pay interest payments related to NB Power from Provincial funds.

4.9.3 Implications for the Province's Borrowing Costs or Capacity

To date, NB Power has accumulated and financed its own debt. The precise impact of the Province assuming some responsibility for servicing NB Power debt repayments if NB Power operates at a cash deficit position is not determinable but presumably it could have a detrimental impact in terms of the Province's borrowing rates and/or the Province's capacity to borrow to meet other Provincial financing commitments.

4.9.4 Implications on Financial Reporting

NBEFC is considered to be a Government Business Enterprise for accounting purposes in the Province's financial statements.

A Government Business Enterprise is a government organization that has all of the following characteristics:

- it is a separate legal entity with the power to contract in its own name and that can sue and be sued;
- it has been delegated the financial and operational authority to carry on a business;
- it sells goods and services to individuals and organizations outside the government reporting entity as its principal activity; and
- it can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

Accordingly, New Brunswick Electric Finance Corporation is considered to be a Government Business Enterprise for the purposes of consolidation onto the Province's financial statements. Therefore, the net results from NB Power are consolidated through NBEFC onto the revenue section of the Province's Statement of Financial Operations (modified equity basis accounting).

Should NB Power cease to be self-sustaining, NBEFC may no longer be considered to be a Government Business Enterprise. The decision of the Province to reverse and revise the decision of the PUB, which is intended to provide decisions about the reasonableness of proposed power rate increases at arms-length from the Province, might impair NB Power's ability to be self-sustaining.

If NBEFC were no longer considered to be a Government Business Enterprise, the current modified equity basis for accounting for NB Power through NBEFC in the Province's financial statements may need to be changed. This change could result in a requirement to fully consolidate the net results and the assets and liabilities of NB Power onto the Province's financial statements. This would have a significant impact including the fact that NBEFC's debt ($3.2 billion at March 31, 2006) would increase the Net Debt of the Province.

4.9.5 Implications on Management Decision-Making

NB Power is intended to operate as a commercial enterprise in respect to setting prices, selling power and managing costs to achieve a reasonable income level and return on investment.

The Province's decision to reverse the decision of the PUB and to direct NB Power to cap electric power rate increases is not consistent with the defined governance relationship between the Province and NB Power, as described in the legislation. This inconsistency in the application of the governance relationship could cause uncertainty on either NB Power's or the Province's part in terms of the objectives that NB Power should be pursuing and the management actions it should be adopting.

4.10 Recommendations

6	The Province should review its overall governance of NB Power and eliminate the perceived inconsistency between its intended policy to have NB Power operate as a commercial enterprise and its actions in terms of limiting NB Power's ability to set rates through the PUB that will allow NB Power to fund its operations and debt obligations.

5. Relationships with Selected Crown Corporations

To review, comment and make recommendations regarding the future impact of the province's financial and ongoing relationship with NB Investment Management Corporation, NB Liquor and NB Power[7].

5.1 Procedures

Based on information from discussions with Provincial representatives and representatives from NB Investment Management Corporation (NBIMC) and NB Liquor (ANBL), and a review of documents provided by the Province, Grant Thornton LLP:

- documented the governance model between the Province and NBIMC and between the Province and ANBL;
- documented the financial relationship and accounting treatment between the Province and NBIMC and ANBL;
- documented the financial estimates for NBIMC and ANBL included in the 2006-07 Main Estimates;
- documented the expected financial results for 2006-07 for NBIMC and ANBL;
- documented key assumptions and future commitments/contingencies for NBIMC and ANBL that could impact the expected net expenditures (loss) and the potential impact of these on the expected fiscal results of the Province; and
- commented on the financial risks related to the current governance models and financial relationships between the Province and NBIMC and ANBL.

[7] The future impact of the Province's financial and ongoing relationship with NB Power is discussed fully in Section 4 – Cap on NB Power Rates.

5.2 Governance and Financial Relationship between the Province and NBIMC

NBIMC was established on December 16, 1994 as a result of the New Brunswick Investment Management Corporation Act. This enabling legislation provided the legal structure for the organization. NBIMC is the trustee and investment manager of various pension plans. Currently, NBIMC manages the Public Service Superannuation Fund, the Teachers' Pension Fund, and the Judges' Superannuation Fund. Combined, there are over 42,500 members. The total assets under management are in excess of $8 billion. In addition to acting as trustee, NBIMC is responsible for developing and implementing investment policy, risk management and custodial services for the pensions under its trust.

NBIMC is controlled by a Board of Directors comprised of the following:

- Chairperson, appointed by Lieutenant-Governor in Council;
- Vice-Chairperson, appointed by Lieutenant-Governor in Council;
- President of the Corporation;
- Deputy Minister of Finance, who is an ex-officio, non-voting member;
- Vice-President, Finance of NB Power Holding Corporation; and
- At least six other members appointed by the Lieutenant-Governor in Council.

A number of Board appointments have not been made on a timely basis. There were cases where terms had expired and time elapsed before the appointment or reappointment of members. Also, there was a period of time when neither the Chairperson nor the Vice-Chairperson was appointed. The position of Chairperson is currently vacant.

When compared to other organizations, the annual compensation paid to NBIMC Board members appears to be below market value for an organization charged with the responsibility of managing over $8 billion in assets.

NBIMC's reporting documents are available through its website. NBIMC prepares and provides annual reports, annual financial statements, and a corporate profile. Currently, NBIMC is updating its strategic plan. Long-term planning is done by management and approved by the Board.

NBIMC operates within a guideline to invest a small portion of its portfolio in New Brunswick companies. NBIMC provides regular updates to Board of Management however there is no evidence of communication regarding the Province's expectations of NBIMC, especially in the areas of risk tolerances, rates of return, and guidance on changes in the asset base with risk tolerance (i.e. whether to maintain the asset base with lower risk, or grow it with a higher level of risk). All investment policy decisions have been made by the Board of Directors and management based on input from the pension plan actuary.

Current investment policy decisions appear to follow a conservative approach to minimize risk. As the pension plans NBIMC manages mature, there is an opportunity to continue to grow the asset base or to simply protect the existing asset base. These decisions will affect the future requirement for the Province to support any unfunded pension liability.

NBIMC does not borrow any money, nor does it generate any profits. NBIMC's operations are funded by revenues generated from the funds managed. NBIMC prepares budgets which are approved by the Board and communicated to the Minister of Finance. Evidence suggests NBIMC is very conscious of its risk exposure, especially the long term risk that the assets of the various pension plans will not be sufficient to cover future pension liabilities.

The Auditor General has completed a detailed value for money review of NBIMC. The final report was not released at the time of this review, but it is expected to include an analysis of the Governance structure, value for money, and NBIMC's overall performance.

5.3 Forecast 2006-07 for NBIMC

NBIMC's operations are funded from revenues it generates from fund management. There is no expected income or loss for 2006-07 related to NBIMC that will impact the Province's fiscal results.

5.4 Recommendations Related to NBIMC

7 The Province should consider its role in reviewing NBIMC's actual results, and reviewing NBIMC budgets and strategy to ensure they are consistent with the Province's expectations of NBIMC. This will allow the Province and NBIMC to ensure they share a clear and common understanding of acceptable risk and growth targets consistent with the Province's fiscal objectives.

5.5 Governance and Financial Relationship between the Province and ANBL

ANBL was established on May 31, 1974 as a result of the New Brunswick Liquor Corporation Act and became the successor and assign of the New Brunswick Liquor Control Corporation. This enabling legislation provided the legal structure for ANBL to carry on the general business of manufacturing, buying, importing, and selling liquor of every kind and description. ANBL operates a distribution system, approximately 125 retail stores, and an agency system with approximately 70 outlets throughout the Province.

ANBL is controlled by a Board of Directors comprised of the following:

- President of the Corporation, who is an ex-officio member, appointed by the Board, subject to approval of the Lieutenant-Governor in Council;
- Chairperson, appointed by the Lieutenant-Governor in Council;
- Vice-Chairperson, appointed by the Board from amongst its members; and
- Six other members appointed by the Lieutenant-Governor in Council.

ANBL reports to the Minister of Finance and the Board of Management. ANBL provides a number of documents and reports on its website. It prepares and provides annual budgets, annual reports and annual financial statements. Currently, ANBL is reviewing its corporate governance, succession planning and risk management. Long-term planning is done by management and approved by the Board. Budgets and five year forecasts are provided to the Department of Finance.

ANBL generates significant annual profits and cash flow. Cash flow management is done on a daily basis in conjunction with the Department of Finance. ANBL has increased its budgets and actual profits over the past ten years consistently. In 2005-2006 ANBL's sales were almost $345 million and ANBL generated a net income of over $126 million. The Province does not participate in the establishment of annual objectives or benchmarks for ANBL's performance.

There is relatively little long term risk to ANBL as it has contracts in place with employees, it is leasing the majority of its premises, and it operates in a government-controlled environment.

PSAB Section 1300 defines a Government Business Enterprise and the methods of accounting for inclusion of such entities' financial data in the Province's financial statements. Today, ANBL is classified as a Government Business Enterprise, and as such, its net financial results are included in the Province's financial statements as a single entry.

5.6 Forecast 2006-07 for ANBL

TABLE 5-1 ANBL Forecast 2006-07

(in millions of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Total Assets	$ 32.9	$ 40.3	$ 40.3	-
Total Liabilities	18.3	26.2	26.2	-
Equity	14.6	14.1	14.1	-
Sales	346	356	358	2
Net Income	$ 126	$ 127	$ 128	$ 1

There are no material variances in actual results, estimates and forecasts for ANBL and no material risks or uncertainties in its future operations are expected.

5.7 Recommendations related to ANBL

8 The Province should consider its role in reviewing ANBL's actual results and ANBL's budgets and strategy to ensure they are consistent with the Province's expectations of ANBL. This will allow the Province and ANBL to ensure they share a clear and common understanding of acceptable risk and growth targets consistent with the Province's fiscal objectives.

6. Relationships with Nursing Homes

To review, comment and make recommendations regarding the Province's relationship and funding of nursing homes including any future obligations for construction and renovation projects.

6.1 Procedures

Based on information from discussions with Provincial representatives and a review of documents provided by the Province, Grant Thornton LLP:

- documented the governance model between the Province and nursing homes;
- documented the financial relationship between the Province and nursing homes and the Province's accounting treatment for nursing homes;
- documented the financial estimates for nursing homes included in the 2006-07 Main Estimates;
- documented the expected financial results for 2006-07 for nursing homes;
- documented key assumptions and future commitments/contingencies for nursing homes that could impact their expected financial position in 2006-07 or the future and the potential impact of these on the expected fiscal results of the Province in 2006-07 and the future;
- quantified the expected financial impact on the Province's expected fiscal results for 2006-07 based on the current forecast of expected financial results for nursing homes and the potential range of key assumptions and future commitments/contingencies; and
- commented on the financial risks related to the current governance models and financial relationships between the Province and nursing homes.

6.2 Nursing Homes Defined

In New Brunswick, nursing homes are designated as level III care facilities, where residents need daily care and attention. Special Care Homes are level II facilities, where residents usually require only supervisory attention and minimal level of care. In the mid-1990's, the eligibility criteria for entering a nursing home became more stringent. This led to the resident population in nursing homes becoming, on average, frailer, and requiring a higher level of care.

Presently, there are 62 nursing homes in New Brunswick, with a total capacity of approximately 4,200 residents.

6.3 Governance and Financial Relationship between the Province and Nursing Homes

All nursing homes in New Brunswick are owned and operated by separate legal, not-for-profit organizations (NPOs), governed by volunteer boards. The Department of Family and Community Services is responsible for the Province's relationship with the nursing homes, and also provides consultation services to the homes. Safety of seniors is of paramount importance to the Department, and inspections of homes are administered under Nursing Home Services within the Department.

The Nursing Homes Act, enacted in 1982, defines the Minister's authority and the duties of the various homes' operators. Sections 22 and 23 of the Nursing Homes Act provide for financial assistance to nursing homes. There are two components of annual financial assistance to nursing homes:

- Formula-based funding, provided in the form of per diem rates to subsidize operating expenditures and mortgage payments (principal and interest); and
- A provision for capital repair and equipment grants.

Also, during a given year, a nursing home may request budget amendments for funding of certain items outside of the nursing home funding formulae.

In the recent past, 65% of total revenues for nursing homes has been provided by the Province. The remaining 35% has been generated by client revenue where nursing home residents pay either all or a portion of the cost.

Regulations pursuant to the Nursing Homes Act were filed in 1985. These regulations address standards for:

- construction, renovation and alterations;
- administration;
- care services;
- physical standards;
- financial reporting; and
- boards of directors of NPOs.

Part V of the Regulations specifies financial reporting to the Department of Family and Community Services by the nursing homes. This regulation indicates nursing homes are required to submit various reports, including an annual budget, to qualify for financial assistance under the Act. Usually, budgets from the nursing homes for a given year are provided by the Department to the nursing homes in the June to July period, after the Main Estimates process has been completed and after the fiscal year is well underway.

Audited financial statements for nursing homes are required to be submitted to the Minister of Family and Community Services by July 31 each year. Monthly reports with respect to resident revenue and vacant bed days are submitted to the Department.

Part VII of the Regulations provides guidance on boards of directors of the nursing homes' NPOs. The regulation indicates nursing homes must be operated on a non-profit basis, and board members cannot serve more than nine consecutive years. Also, there are restrictions regarding persons who are eligible to serve on nursing home boards. Exclusions include employees of the Department of Family and Community Services and members of the Legislative Assembly of New Brunswick. These exclusions effectively recognize the independent nature of these boards and corporations.

In 2004, the Office of the Auditor General (OAG) conducted an audit of compliance practices with Provincial Legislation in regard to the Department of Family and Community Services and the provision of nursing home services. The OAG concluded the legislation for nursing homes was in need of review and amendment.

Because nursing homes are separate legal entities, they are not part of the Government Reporting Entity. Funding to nursing homes is recorded as expenditures by the Department of Family and Community Services.

6.4 Nursing Home Renovation and Construction

In 2004, the Province embarked on a multi-year nursing home renovation and construction plan aimed at the construction, replacement and renovation of nursing homes in New Brunswick, working through the various NPOs. The plan includes upgrades and improvements to nursing home infrastructure at twelve locations throughout the Province, and the addition of approximately 100 new beds to the nursing home system. Original estimates put the cost of these upgrades and additions at approximately $120 million, to be financed by the NPOs that own the respective nursing homes. The Province committed to providing the required debt servicing funds in the respective homes' annual budget allocation over the life of the long-term financing loans.

6.5 Changes to Funding Policies for Nursing Homes

Significant changes to the policies for funding nursing homes were announced in 2005 and 2006. These policy changes will have an impact on fiscal results in 2006-07 as they begin to take effect, and will have an even greater fiscal impact in 2007-08, 2008-09 and subsequent fiscal years, when they become fully implemented. These funding policy changes are described below.

Elimination of requirement for use of personal assets	As of October 3, 2006, the requirement for residents to contribute funds from their personal assets to cover care costs has been eliminated.
Maximum user-pay per-diem rates	The maximum per diem amount an individual is expected to pay (if they are financially able) for nursing home care has been standardized across the province and decreased to $70 per day from an average of $143 per day. This policy change originally set the maximum rate at $79 per day, but this has recently been further reduced to $70 per day. The new policy will become effective as of January 1, 2007.
Increases in hours of care	The per diem funding for nursing homes is being adjusted to reflect an increase in the funded average hours of care for residents from 2.65 hours per day to 3.0 hours per day. When announced in June 2006, the increase was to be phased in through annual increases starting January 1, 2007 through 2009, with a planned 2007 increase to 2.85 hours. Recently, the timetable was accelerated to increase hours of care to 3.0 hours effective October 3, 2006, and to 3.50 hours effective April 1, 2009.
Increase in the comfort and clothing allowance	There is an increase in the comfort and clothing allowance for residents from $102 per month to $200 per month. The effective date for this increase has not been announced. It is estimated this increase will result in an incremental cost of $3.8 million per year.

6.6 Forecast 2006-07

The 2006-07 forecast provided by the Department of Family and Community Services reflects an estimated $7,401,300 increase in spending compared to the 2006-07 Main Estimates of $165,531,000 as shown in Table 6-1 below[8].

Table 6-1: Forecasted Expenditure Variance

(in thousands of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Family and Community Services - Nursing Home Funding	$ 145,508.0	$ 165,531.0	$ 172,932.3	$ (7,401.3)

6.7 Material Variances from Main Estimates

The $7.4 million variance between the forecast spending for nursing homes and the Main Estimates is attributable to changes in nursing home budgets since the Main Estimates were approved, changes to previously announced funding policies for nursing homes and collective agreement settlement costs.

6.7.1 Nursing Homes Budgets Set after the Main Estimates

The Department of Family and Community Services submits its requested budget related to nursing homes to the Department of Finance for inclusion in the Main Estimates early in the calendar year. After the Main Estimates are approved, nursing homes are provided with their approved budgets from the Department of Family and Community Services. This typically occurs in June or July. As a result, decisions about the approved per diem funding for nursing homes made in late summer or fall may result in a variance between the amount provided for nursing homes funding in the Main Estimates and forecast expenditures.

6.7.2 Funding Policy Changes

Recent changes to the previously announced new funding policies for nursing homes will result in increased spending in the current fiscal year as shown below[9].

[8] Note that the variance described here relates to Department of Family and Community Services funding for Nursing Homes only and does not represent the full Estimate for the Department of Family and Community Services.

[9] This represents the incremental costs of new funding policies for nursing homes only and do not include incremental costs related to new funding policies for homes for special care.

Elimination of requirement for use of personal assets	The cost to implement this policy, with an effective date of October 3, 2006.	$4.50m
Maximum user-pay per diem rates	The reduction in the maximum user-pay per diem rate from the $79 maximum included in the Main Estimates to a $70 maximum.	$0.50m
Increases in hours of care	The acceleration of the timetable for the increase in the hours of care to 3.0 hours.	$2.40m

6.8 Risks and Uncertainties related to the 2006-07 Forecast

Financial forecasts are based on assumptions about future events and circumstances and actual events and circumstances may vary from these assumptions. As a result, the actual fiscal results and financial position of the Province at March 31, 2007 may vary from the forecast position provided in this report.

6.8.1 Pension Plan Deficiencies

Actuarial valuations of three nursing home pension plans have identified deficiencies. In March 2006, the Superintendent of Pensions issued an order for the nursing homes to make special payments to address the solvency deficiencies in the nurses and CUPE plans. The Nursing Homes Association appealed the order, and the appeal was heard on October 27, 2006. According to the Department of Family and Community Services, the adjudicator did not issue any ruling at the hearing, and there is no indication of an expected date for a ruling at this time.

These pension plans are not Provincial plans, and therefore, any funding requirement legally rests with the nursing homes. However, because the Province primarily provides the necessary funds to operate the nursing homes, there is uncertainty with regards to the funding of the deficiencies of the pension plans.

6.8.2 Announcements Related to Funding Policies

The Government announced an intention to increase the comfort and clothing allowance for residents of nursing homes from $102 per month to $200 per month but has not announced the effective date for this change. It is estimated this increase will result in an incremental cost of $3.8 million per year.

6.8.3 Outbreak of Pandemic Flu

The Department of Family and Community Services' will incur an expense in the 2006-07 fiscal year of $2 million to fund the cost of creating a base level of supplies in anticipation of a potential outbreak of the pandemic flu. However, if a pandemic flu outbreak were to occur, the financial implications of the event could exceed the provision included in the 2006-07 Main Estimates significantly and have an impact on the Province's fiscal results in the current or future years.

6.9 Implications beyond 2006-07

6.9.1 Historical Expenditure Trends

Historically, nursing home costs have increased by approximately 3% annually as a result of increased prices and demand. In the absence of any changes to nursing home operations, it is expected that this trend would continue.

6.9.2 Annualized Impact of Funding Policy Changes

In addition to a current fiscal year impact, each of the funding policy changes has an impact on funding levels in ensuing years, as shown in Table 6-2.

Table 6-2: Projected Annual Impacts of Policy Changes

(in thousands of dollars)

Policy Change	**2007-08**	**2008-09**	**2009-10**
Elimination of use of personal assets	$ 9,000	$ 9,000	$ 9,000
Reduction in per diem rate	17,100	17,100	17,100
Increase in hours of care	4,200	24,800	24,800
Total Policy Impact	**$ 30,300**	**$ 50,900**	**$ 50,900**

The annualized impact of the elimination of the use of personal assets to fund nursing home costs is expected to be $9 million.

The reduction of the daily per diem rate to $70 is expected to result in an annualized cost of $17.1 million.

The increase in hours of care to 3.0 hours is expected to cost the Province $4.2 million per year. The increase from 3.00 to 3.5 hours is expected to cost an additional $20.6 million per year, starting in the 2008-09 fiscal year, for a total annual expected impact of $24.8 million.

6.9.3 Capital Construction Projects

The Province is in the midst of a major infrastructure upgrade plan involving twelve nursing homes. Currently, capital costs for these 12 projects are estimated at $135 million, which will be financed by the nursing home NPOs. This incremental financing will bring the total long-term debts on nursing homes' financial statements to approximately $235 million over the next two years.

In the past, the Province has guaranteed some long-term debts to nursing home corporations for various lenders. The Province's March 31, 2006 financial statements indicate $9.4 million, or approximately 10% of the $100 million current outstanding long-term debt of the nursing homes corporations, was guaranteed by the Province. The Province does not expect to be required to sign guarantees for the new financing agreements with the homes related to the current phase of capital improvements.

The Province provides the funding for the principal and interest payments on the nursing homes' debt financing each year through the per diem rate subsidy. As well, the Province provides funding for increased operating costs resulting from the capital improvements. The impact of this funding over the next three years is shown in Table 6-3.

Table 6-3: Projected Annual Impact of Nursing Home Upgrades

(in thousands of dollars)

Item	2007-08	2008-09	2009-10
Renovations to 12 homes	$ 7,466	$ 14,545	$ 14,833

Very little refurbishment of other nursing home facilities in the Province has taken place over the past 20 years, and future capital requirements may be substantial.

6.9.4 Cumulative Impact of Funding Increases

Table 6-4 provides a six-year comparison/projection of total Provincial funding, using budgeted fiscal results beginning in 2004-05 and 2005-06, forecasted results for 2006-07 and projected results through to 2009-10. The projections for future years assume that nursing home program costs will continue to rise at the historical average rate of 3%. This provides a picture of the total impact of policy and operational changes that have occurred or are expected to occur in the next few years. In effect, the $127 million budget in 2004-05 is expected to double to approximately $254 million by 2009-10 as a result of the government initiatives and other factors referred to above. These projections do not include any funding to address pension plan deficiencies.

Table 6-4 Total Provincial Funding Commitment 2004-2005 through 2009-2010

(in thousands of dollars)

	2004-05	Estimate 2005-06	2006-07	Forecast 2006-07	2007-08	Projected 2008-09	2009-10
Total	$ 127,296	$ 138,896	$ 165,531	$ 173,412	$ 217,802	$ 251,224	$ 254,041
% increase in Estimates		9.1%	19.2%		31.6%	15.3%	1.1%

The Province's financial commitment to nursing homes to enhance physical facilities, to increase funded care levels and services, and to lower user contributions will increase government subsidies for nursing home services from 65% to 85% of total funding over the next two fiscal years.

6.9.5 Changes in Demand

Trends in terms of demand for nursing homes as described below will also impact the future costs of funding nursing homes as described below.

Aging population	An aging population could increase demand for beds, lengthening waiting lists, which currently, are relatively short.
Increasing demand for nursing home beds	The reduction in daily user rates from an average of $143 per day to $70 per day could make nursing homes more attractive to seniors, significantly increasing the demand for beds. This was the experience when similar daily rate reductions were implemented in Nova Scotia.
Increasing acuity	The level of care required for residents in nursing homes has been increasing resulting in proportionally higher costs of care in nursing homes.
Preference for single rooms	The trend to private single rooms, as has been witnessed with the renovation and replacement capital program currently underway, could drive up capital and operating costs.
Staffing challenges	The projected shrinking workforce could make finding sufficient trained staff a challenge.

6.9.6 Impact of Funding Increases on Governance and Accounting Treatment

Changes to funding polices and the approval of 12 capital projects will increase the proportion of funding that nursing homes receive from the Province from 65% to 85%. As a result, nursing homes are becoming increasingly financially reliant on the Province. In addition, approximately half of the province's nursing homes have accumulated operating deficits which are not a Provincial liability but do place pressure on government funding sources.

Currently, the Province has determined that nursing homes are not part of the Government Reporting Entity because they are not controlled by the Province. PSAB 1300.18 identifies the following indicators that provide evidence that control might exist:

- government has the power to unilaterally appoint or remove a majority of the members of the governing body of the organization;
- government has ongoing access to the assets of the organization, has the ability to direct the ongoing use of those assets, or has ongoing responsibility for losses;
- government holds the majority of the voting shares or a "golden share" that confers the power to govern the financial and operating policies of the organization; and
- government has the unilateral power to dissolve the organization and thereby access its assets and become responsible for its obligations.

PSAB 1300.19 identifies the following other indicators that may provide evidence that control exists.

When the government has the power to:

- provide significant input into the appointment of members of the governing body of the organization by appointing a majority of those members from a list of nominees provided by others or being otherwise involved in the appointment or removal of a significant number of members;
- appoint or remove the CEO or other key personnel;
- establish or amend the mission or mandate of the organization;
- approve the business plans or budgets for the organization and require amendments, either on a net or line-by-line basis;
- establish borrowing or investment limits or restrict the organization's investments;
- restrict the revenue-generating capacity of the organization, notably the sources of revenue; and
- establish or amend the policies that the organization uses to manage, such as those relating to accounting, personnel, compensation, collective bargaining or deployment of resources.

PSAB 1300.24 provides further clarification that is relevant to the issue of government's control of nursing homes and says:

"An organization's financial dependence on the government, in and of itself, does not constitute control. While financial dependence would usually give rise to a relationship based on influence, it is unlikely that financial dependence alone would enable the government to control an organization. The governing body of that organization may make independent decisions on its financial and operating policies. A government may require the organization to submit reports to demonstrate compliance with the terms and conditions of funding. These reports are not considered evidence of control because the government's interest in the organization extends only to the funding aspects of operations. For example, a private sector day care service that receives government funding may be required to demonstrate compliance with the terms and conditions of government funding. However, the governing body retains discretion as to whether it will take funding from, or do business with, the government."

Accordingly, the Province will have to monitor whether the changes to funding policy that give rise to these changes in proportional funding constitute a change in the Province's judgement as to whether government controls nursing homes. Should the Province determine that it has control of nursing homes, it would be required to recognize nursing homes as part of the government reporting entity and this could have significant implications for the liabilities and future fiscal results of the Province.

6.10 Recommendations

9 The Province should review and update the Nursing Home Act and Regulations as required to reflect changes in the sector, and to update the governance and financial relationships between the Province and nursing homes.

10 The Province should develop a long-term plan for future phases of capital upgrades to nursing homes which may require refurbishments over the next ten to fifteen years, to assist the Government in future budget planning.

11 The Province should continue to encourage nursing home financing amortization periods of no more than 20 years, to reflect the expected lifespan of facilities improvements, and the fixing of rates for between 10 and 20 years, to take advantage of relatively low interest rates.

12 Given the growing demands on nursing homes and the changes to funded hours of care, the Province should investigate the need to train additional registered nurses, nursing assistants and resident attendants to meet future staffing needs.

13 The Province should continue to assess whether changes to funding policies and the resulting impact on the proportion of funding that nursing homes receive from the Province have any impact on the Province's judgement as to whether or not government controls nursing homes as defined in PSAB.

7. Funding Status of Pension Plans

To review, comment and make recommendations regarding the funding status of public-sector pension plans.

7.1 Procedures

Based on information from discussions with Provincial representatives and a review of documents provided by the Province, Grant Thornton LLP:

- documented the current funding levels of pension plans {Public Service Superannuation Plan (PSSA),Teachers' Pension Plan (TPA), Provincial Court Act and Provincial Court Judges' Pension Act (Judges'), Members; Superannuation Plan and Members' Pension Plan (Members'), Pension Plan for Canadian Union of Public Employees of New Brunswick Hospitals (H-CUPE), Pension Plan for Management Employees of New Brunswick School Districts (Sch-Mgt), Pension Plan for General Labour, Trades and Services Employees of New Brunswick School Districts (GLTS), Pension Plan for Full-Time CUPE 2745 Employees of New Brunswick School Districts (CUPE 2745), Ombudsman Plan (Ombud), Pension Plan for Certain Bargaining Employees of New Brunswick Hospital (H-CBE), Pension Plan for Part-time and Seasonal Employees (Part-time), Early Retirement / Workforce Adjustment Programs (Early Ret);
- documented the basis for accounting for the pension plans;
- commented on the adequacy of the pension funds;
- quantified the potential impact on the Province's financial position related to changes in the funding levels for the pension funds; and
- commented on the appropriateness of pension plan funding policies and current accounting treatments for pension plans.

7.2 Pension Plans Defined

PSAB Section 3250 provides a description of the two principal types of pension plans, being defined benefit plans and defined contribution plans. The Province has 12 pension benefits plans as listed above, 11 of which are defined benefit plans and one of which is a defined contribution plan. Of the 11 defined benefits plans, 2 have fixed employer contributions.

The Province is liable for any excess of pension liabilities over pension assets for the remaining 9 plans.

7.2.1 Pension Plan Funding

Actuarial valuations are performed to calculate the contributions required for pension plan funding. The actuary evaluates the pension plans utilizing the going concern and solvency methods. The pension plans are funded on a going concern basis as the plans are expected to continue into the foreseeable future.

The Province has an Actuarial Valuation Committee (AVC) comprised of senior level staff. The AVC duties include the review of draft actuarial reports including the recommended assumptions proposed by the actuary. The committee is kept informed of changes that may affect funding of the plans by the actuary.

Table 7-1 below provides a summary of the current level of funding for the 11 pension plans.

The two largest plans, the Public Service Superannuation Act Plan (PSSA) and the Teachers Pension Act Plan (TPA), account for approximately 80% of total pension plan assets and pension plan liabilities (estimated accrued benefits). Various Provincial entities participate in the PSSA (the largest Provincial pension plan) and, accordingly, calculations are performed to estimate the actual Provincial Government Reporting Entity's share of the current pension expense, and the pension assets/liability reported for accounting purposes.

Legislation is in effect regarding the funding of pension plan shortfalls for the two largest plans (PSSA and TPA) and the Judges' pension plan. This legislation requires the Board of Management to introduce special payments to fund actuarial deficits. Accordingly, the Board of Management approved in 2003-04 to reinstate special payments to PSSA and TPA pension plans to fund actuarial deficits. When these special payments are recorded in the accounting records, there is a no direct effect on pension expense, surplus and net debt. The effect of the special payments is not a current year increase in pension expense, but rather a reduction of the pension liability already recognized on the financial statements which reduces the interest component of pension expense in future years.

The other pension plans are not subject to the same legislated requirement for special payments to address actuarial deficits.

Table 7-1 Pension Funding

(in millions of dollars)

Actuarial Valuation Reports	Public Service Superannuation Act (PSSA)	Teachers Pension Act (TPA)	Other Plans	Totals
Actuarial Valuation for Funding Purposes	04/01/2005	Draft 04/01/2006	Various	
Going Concern Basis				
Plan Assets	$ 3,755.2	$ 3,734.0	$ 1,431.1	$ 8,920.3
Plan Liabilities	(4,079.4)	(3,904.2)	(1,580.7)	(9,564.3)
Plan Surplus/(Deficit-unfunded liability)	***(324.2)***	***(170.2)***	***(149.6)***	***(644.0)***
Funding Ratio	92.1%	95.6%		

The going concern basis suggests there is an under funding of the actuarial obligation since the last triennial valuations across all plans of approximately $644 million. The two largest plans are actuarially under funded by $324.2 million for the PSSA and by $170.2 million (draft) for the TPA. These figures are subject to change as new actuarial information is received. The TPA plan actuarial information is based upon a draft triennial valuation as of April 1, 2006. The PSSA is due for its actuarial valuation for funding purposes on April 1, 2008.

The $644 million unfunded liability does not include any amount respecting the early retirement program actuarial valuation that is presently in progress. (For accounting purposes, the early retirement program has an unfunded liability position of $148.1 million as at March 31, 2006.)

The resulting funding ratios on a going concern basis for the two largest pension plans are 92.1% for the PSSA and 95.6% (draft) for the TPA. Although these funding ratios are less than 100%, it is important to remember that these two plans are subject to legislated special payments to correct under-funding and special payments were reinstated in 2003-04.

7.2.2 Estimated Funding Requirements for Pension Plans

PSAB Section 3250 indicates, in broad form in general terms, that the expense related to pension plans should be recorded as the employee is rendering service, as opposed to being recorded upon payment at retirement. An estimate of the future liability related to pension benefits and an estimate of the value of the year-end pension asset base are required to calculate the annual projection of the pension benefits expense (or current period service cost) to be recorded in the Main Estimates and to develop the Forecast.

Estimation of the pension benefits expense includes estimates of current period service costs, imputed net interest and amortization of any experience gains or losses. The calculation is complex and actuarial calculations or extrapolations of actuarial estimates are required across multiple plans. Actuarial valuations for funding purposes are typically done triennially.

The Province has recognized expenses related to pension benefits as is indicated in PSAB Section 3250 Retirement Benefits, although it does not have a documented accounting policy specific to pension benefits. A documented policy may include the following:

- detailing the frequency of actuarial involvement for valuation purposes by plan,
- the process regarding the annual extrapolation and responsibilities regarding same (management/actuary) by plan,
- the definition of the Governmental Reporting Entity to be included in the calculation process and frequency of review regarding the elements to be accounted for,
- functions and role of the Actuarial Valuation Committee and any other key committees or offices involved in the process.

In addition, the Province's accounting related to pension benefits is subject to audit by the Office of the Auditor General, who has provided an unqualified audit opinion.

7.2.3 Accounting for Pension Plans

For purposes of estimating the pension expense to be recorded on the financial statements, the actuarial calculations consider known liabilities, assets and employee services rendered to the last actuarial valuation, and extrapolated by management and/or the actuary to the current accounting date. Consideration of possible future asset returns and current service payments on account of future services are dealt with in future accounting periods, as employee service is rendered at that time.

As shown in Table 7-2 below, the estimate of the actuarial pension liability for accounting purposes indicates the two largest pension plans have a surplus (pension assets in excess of liabilities) for accounting purposes of $69.2 million and $54.7 million for the PSSA and the TPA respectively, after consideration of net unamortized gains. That is, for accounting purposes as of the measurement date, the PSSA and TPA plans are funded in excess of the year-end liability for services rendered to that date. The strong investment market performance in 2005-06, along with the special pension contributions made since 2003-04, contributed to this result.

The actuarial calculation for the PSSA pension, prepared by the Province's actuary provide a separate calculation of NB Power's pension amounts and NB Power's PSSA assets are separated from the Province's PSSA assets (via a notional calculation). This segmented information is not provided for any other provincial agency.

Of the pension liability "Other Plans" in Table 7-2, $148.1 million of the $154.1 million relates to the early retirement program. The early retirement program therefore has an unfunded liability of this amount as at March 31, 2006. This circumstance is expected and planned for. However, if the early retirement program payments exceed expectations significantly in any one year (e.g. a new early retirement program is established), an increase in total debt may be necessary at that time.

Table 7-2 Actuarial Valuation of Pension Plans for Accounting Purposes

(in millions of dollars)

Accounting Values Reported-3/31/06	**Public Services Superannuation Act (PSSA)**	**Teachers Pension Act (TPA)**	**Other Plans**	**Totals**
Accounting Actuarial Valuation	04/01/2005	04/01/2005	Various	
Assets	$ 3,379.7	$ 3,730.2	$ 339.4	$ 7,449.3
Estimated Accrued Benefits	3,260.8	3,601.7	462.0	7,324.5
Actuarial Pension Surplus (Liability)	118.9	128.5	(122.6)	124.8
Unamortized gains	49.7	73.8	31.5	155.0
Pension Asset (Liability)	***$ 69.2***	***$ 54.7***	***$ (154.1)***	***$ (30.2)***

7.3 Forecast 2006-07

Table 7-3 Forecast 2006-07

(in millions of dollars)

	2005-06 Actual	**2006-07 Main Estimates**	**2006-07 Forecast**	**2006-07 Variance**
Pension Expense (for all primary defined benefit plans, excludes H-CBE and Part Time Plans)	$ 89	$ 92	$ 90	$ 2

7.4 Material Variances from Main Estimates

While the Province anticipates total pension expenses for 2006-07 will be commensurate with the provision made in the Main Estimates, there are three significant, but offsetting components, underlying this forecast:

- The forecast interest expense (or net liability growth factor) compared to the 2006 actual net liability growth rate has decreased by approximately $30 million. Most of the decrease has resulted from a higher pension assets base in the PSSA and TPA plans. This is expected to generate a higher return on assets which will reduce pension interest expense on the net liability accordingly.
- In 2006-07 the TPA's unamortized pension adjustment will record a forecasted $154 million actuarial loss. This actuarial loss will be amortized over the Expected Average Remaining Service Life (EARSL) of the related employee group and therefore is affecting the pension expense calculation. The actuarial valuation related to TPA has not been finalized.
- There are forecasted increases in current service cost of approximately $7 million across the pension plans.

7.5 Risks and Uncertainties related to the 2006-07 Forecast

7.5.1 Uncertain Nature of Actuarial Valuations

As with any estimate based on assumptions about future events, the estimate of the future liability related to pension benefits is limited by the validity, faithfulness and accuracy of the underlying supporting data available at the time the estimate was made and actual results may vary materially from the estimate.

7.5.2 Market Rates of Return

Overall pension asset performance in the investment markets and the related amortization of experience gains and losses will impact pension expense. The extent of this impact on the 2006-07 forecast will depend on the degree to which actual market performance varies from the assumptions used to prepare the 2006-07 Main Estimates.

7.5.3 Updated Actuarial Valuations

Updated actuarial reports are expected in the near future (for the TPA and Early Retirement Plans) and information from these valuations may impact the related pension expense calculations. Also, annual actuarial valuations for accounting purposes (effective date April 1, 2006) are currently being prepared on the PSSA and TPA plans. Updated information will become available as the actuarial process and related reporting unfolds, and may impact the 2006-07 forecast.

7.6 Implications beyond 2006-07

The risks and uncertainties identified for the 2006-07 forecast could also have implications on the Province's future fiscal results. In addition, the following emerging trends could also impact the future fiscal results of the Province in terms of its pension funding, pension liabilities and pension expenses.

7.6.1 Emerging Trends that May Impact Pension Liabilities

The Province uses a prudent, disciplined approach to pension plan funding, supported by an underlying infrastructure of funding policies, practices and legislation.

The following trends related to the Province's pension plans could have an impact on the future fiscal requirements related to the funding of pension plans.

Longer life expectancy	Actuarial valuations have indicated recent trends regarding longer life expectancy which could increase pension liabilities. This impact has been offset somewhat by gains on pension assets as a result of market fluctuations in recently performed valuations related to the Province's pension plans.
Interest	An interest rate is applicable to the pension liability and assets in determining pension expense. A lower interest rate has been emerging in more recent actuarial valuations. These lower interest rates are serving to decrease the interest component of pension expense.
Modifications or improvements to plans	There have been no significant plan modifications/improvements within the last 10-12 years which assisted in ensuring adequate funding is in place for existing obligations. If future contract negotiations result in changes to the benefit entitlements or membership of pensions, these changes could have a material impact on the Province's fiscal results related to pension plans.
Early retirements	A number of pension plans are experiencing early retirements, which results in a plan loss if the employee retires ahead of expectations.
Special Payments	Special payments will continue as long as there is an unfunded liability in the legislated pension plans.

7.6.2 Changes to the Government Reporting Entity

Any future changes to the composition of the Government Reporting Entity could impact the pension expense and liability positions (to the extent that any new reporting units to be included have pension plans encompassed by PSAB Section 3250).

7.6.3 Future Contract Negotiations

Any future contract negotiations undertaken which would possibly affect pension entitlements or related calculations through plan amendments/improvements may have a significant impact on the actuarial accounting liability as well as the actuarial funding valuation figure determined.

7.7 Recommendations

14 The Province should consider developing an accounting policy respecting pensions. A documented policy may include those items indicated in section 7.2.2.

15 The Province should develop an inventory of pension plan obligations recorded across the Government Reporting Entity and its agencies to ensure all benefits have been completely and appropriately accounted for.

16 The Province should review the basis for the segregation of NB Power's pension amounts and PSSA assets in the actuarial calculations related to the PSSA pension plan and determine whether similar segregated calculations should be performed for other provincial agencies.

17 The Province should continue to monitor the results of all actuarial valuations performed and ensure any new information is adequately addressed for accounting and funding purposes. The Early Retirement Plan valuation should be reviewed closely as there may be new trends emerging given that the last valuation on this plan was performed in the mid 1990's.

8. Accounting for Retirement Allowances

To review, comment and make recommendations regarding the accounting for retirement allowances excluding pension plans.

8.1 Procedures

Based on information from discussions with Provincial representatives and a review of documents provided by the Province, Grant Thornton LLP:

- documented the current accounting policy for retirement allowance benefits excluding pension funds;
- documented PSAB standards and exposure drafts related to accounting for termination benefits;
- documented the amounts included in the 2006-07 Main Estimates for retirement allowance benefits;
- quantified the expected fiscal results of accounting for retirement allowance benefits for the upcoming fiscal period under the current accounting policy;
- quantified the expected fiscal results of a change to accounting policy based on PSAB's current or proposed standards for the accounting for retirement allowance benefits for the upcoming fiscal period; and
- commented on the appropriateness of the Province's current accounting policy for retirement allowance benefits.

8.2 Background

PSAB Section 3255 provides guidance related to accounting for post-employment benefits, compensated absences and termination benefits (retirement allowance programs) for the public sector. The only termination benefit identified by the Province under PSAB Section 3255 is the retirement allowance program.

PSAB indicates that expenses related to retirement allowance benefits should be recorded as the employee is rendering service, as opposed to being recorded upon payment at retirement. Therefore, an estimate of the future liability related to retirement allowance benefits is required to calculate the annual amount of the retirement allowance benefit expense (or current period service cost) to be recorded.

The estimate of the future liability is complex and actuarial calculations or extrapolations of actuarial estimates are prepared. Typically, actuarial valuations are done triennially (or periodically) with an extrapolation performed by management or the actuary in the intervening period for accounting purposes.

The Province generally recognizes expenses related to termination benefits as is indicated in PSAB Section 3255 although the Province does not have a documented accounting policy specific to retirement allowance benefits. A documented policy may include the following:

- detailing the frequency of actuarial involvement for valuation purposes,
- the process regarding the annual extrapolation and responsibilities regarding same (management/actuary),
- the definition of the Governmental Reporting Entity to be included in the calculation process and the frequency of review regarding the elements to be accounted for,
- frequency of regular reviews of other benefit plans offered by the Province to determine if other benefit plans require similar accounting treatment,
- functions and role of the Actuarial Valuation Committee and any other key committees or offices involved in the process,
- policies or structure for review of key decisions in the retirement allowance accounting calculations etc.

In addition, the Province's accounting related to retirement allowance benefits is subject to audit by the Office of the Auditor General, who has provided an unqualified audit opinion.

8.3 Current Estimate of the Province's Liability related to Retirement Allowance Benefits

The last actuarial valuation of the liability related to pension benefits was completed in the late 1990's.

Recently, the Province commissioned an actuarial report detailing the value of the expected liability based on the expanded Government Reporting Entity and updated assumptions underlying the estimated liability.
In 1999, the Province's Government Reporting Entity was redefined to include Regional Health Authorities. The draft valuation report shows an increase in the estimated liability related to retirement allowance benefits of approximately $80 million. .This draft actuarial report has not been formally reviewed by the Actuarial Valuation Committee and the Province is in the process of determining the appropriate accounting treatment for the revised liability estimate.

8.4 Forecast 2006-07

TABLE 8-1 FORECASTED EXPENDITURE VARIANCES

(in millions of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
General Government - Retirement Allowance Expense	$ 27	$ 27	$ 37	$ (10)

8.5 Material Variances from Main Estimates

Following receipt of the draft valuation report, an updated calculation of the estimated annual current service cost and interest on the liability indicated the 2006-07 retirement allowance expense will be $10 million greater than the provision made in the Main Estimates.

8.6 Risks and Uncertainties related to the 2006-07 Forecast

8.6.1 Uncertain Nature of Valuations

As with any estimate based on assumptions about future events, the estimate of the future liability related to retirement allowance benefits is limited by the validity, faithfulness and accuracy of the underlying supporting data available at the time the estimate was made, and actual results may vary materially from the estimate.

8.6.2 Basis for the Actuarial Calculation

Given the short timelines provided to prepare the draft actuarial calculation to estimate the liability related to retirement allowance benefits, the calculation was done based on extrapolation of data from 2003. Because the data on which the actuarial calculation was prepared is not current, there is a risk that more current data would yield a different estimated liability and the revised estimated liability may have an .impact on the fiscal results of the Province.

8.6.3 Accounting Treatment for the Incremental Estimated Liability

The draft valuation report shows an increase in the estimated liability related to retirement allowance benefits of approximately $80 million. The Province is in the process of determining the appropriate accounting treatment for this increase. The options include, but are not limited to:

- Amortizing the $80 million change in the estimated liability prospectively over 14 years, a period which is equivalent to the Expected Average Remaining Service Life (EARSL) of the plan. This accounting treatment smoothes the impact of the $80 million liability increase over the employees' service period. If this accounting treatment is adopted, the incremental annual amortization expense related to the incremental estimated liability will be $5.7 million.
- Accounting for the entire estimated liability as a retroactive adjustment because the revised valuation report is the first complete valuation report done since the late 1990's and therefore the revised valuation may represent the formal adoption of PSAB Section 3255. Under this accounting treatment, the incremental estimated liability may be reported retroactively along with a corresponding increase in net debt. This accounting treatment would need to be reviewed by the Auditor General because it deals with a prior period for which the Auditor General has already issued an opinion.
- Accounting for the portion of the $80 million increase in the estimated liability related to the Regional Health Authorities as a retroactive adjustment because inclusion of the Regional Health Authorities in the Government Reporting Entity occurred subsequent to the last valuation. The remaining portion of the incremental estimated liability would be amortized over the EARSL (14 years). This accounting treatment would need to be reviewed by the Auditor General because it deals with a prior period for which the Auditor General has already issued an opinion.
- Accounting for the full incremental estimated liability in the current year. This option has limited theoretical support in accounting standards as significant effects of prior years' service would be brought into the current year expense.

Any of the above options that involve changes to prior periods are by their very nature more complex. Subject to a discussion with the Auditor General regarding his views of these options and the materiality of the amounts involved, a determination may be made that the issue does not warrant a complex treatment such as retroactive restatement due to materiality considerations.

The final accounting for this estimated liability must be compliant with generally accepted accounting principles as prescribed by PSAB.
As the draft actuarial report has just been released, the Actuarial Valuation Committee has not had an opportunity to meet and review the report. Therefore, the Province's validation process respecting this report is ongoing.

8.7 Implications beyond 2006-07

The risks and uncertainties identified above could have implications on the Province's future fiscal results.

8.8 Recommendations

18	The Province should determine the most appropriate accounting treatment for the incremental estimated liability related to retirement allowance benefits and the related note disclosure.
19	The Province should consider commissioning an actuarial valuation using current data to estimate the liability of retirement allowance benefits.
20	The Province should develop an accounting policy respecting retirement allowance benefits. A documented policy may include those items indicated in Section 8.2.
21	The Province should develop an inventory of benefit programs offered within the Government Reporting Entity to ensure all benefits have been completely and appropriately accounted for.
22	The Province should consider changing the terminology it uses to refer to various benefit programs to be consistent with PSAB guidance to promote clarity in the interpretation of accounting guidance related to these benefit programs.
23	In making any future changes to the Government Reporting Entity, the Province should continue to consider all additional accounting and reporting requirements and allow appropriate lead times to prepare required information, such as actuarial valuations and other estimates.

9. Regional Health Authorities Expenditure Review

To review, comment and make recommendations regarding the repetitive nature and cause of Regional Health Authority deficits.

9.1 Procedures

Based on information from discussions with Provincial representatives and Vice Presidents from four Regional Health Authorities, and a review of documents provided by the Province, Grant Thornton LLP:

- documented the governance model between the Province and the RHAs;
- documented the financial relationship and accounting treatment between the Province and the RHAs;
- documented current Department of Finance, Department of Health and RHA business planning and funding processes as they relate to RHAs;
- documented the last 3 years of financial results of RHAs, and current year expected financial results against the funding estimates in the 2006-07 Main Estimates; and
- identified the key issues that result in the repetitive nature of RHA deficits.

9.2 Background

9.2.1 Financial Relationship between the Province and RHAs

Regional Health Authorities (RHAs) are considered to be part of the government reporting entity, and therefore, their fiscal results are fully consolidated into the Province's Statement of Operations.

9.2.2 RHA Governance Model

The Regional Health Authorities were created through the Regional Health Authorities Act of 2002.

The business and affairs of an RHA are managed and controlled by a Board of Directors comprised of 15 voting members (7 of whom are appointed by the Minister and 8 of whom are elected) and three non-voting members – the CEO, the Chairperson of the professional advisory committee and the chairperson of the medical advisory committee. The Board reports directly to the Minister of Health.

The CEO reports to the Deputy Minister of the Department of Health, and is responsible for the general management and conduct of the affairs of the RHA within the by-laws, policies and directions of the Board.

The RHA is required to determine the health needs and priorities of the population it serves, and to allocate resources according to the regional health and business plan. In accordance with the Act, the RHA may only provide services where there is a need, where the services are included in the plan approved by the Minister of Health, where the services are consistent with the provincial health plan, and where sufficient resources are available.

9.2.3 The Provincial Health Plan

The RHA Act indicates the Minister of Health shall establish a provincial health plan which shall include:

a. the principles upon which the provision of health services in the province are to be based;

b. the provincial objectives and priorities for the provision of health services in the Province or areas of the Province;

c. the health services to be provided or made available by a regional health authority within its region, and where applicable, outside of its region;

d. the health services to be acquired by the Minister of Health from outside of the Province;

e. the provincial programs for the provision of health services in the province;

f. the nature and scope of any basic or applied research initiatives that are to be conducted in relation to health care and health services;

g. the programs for training of persons in the medical and other health professions, including practice settings for the training of health professionals;

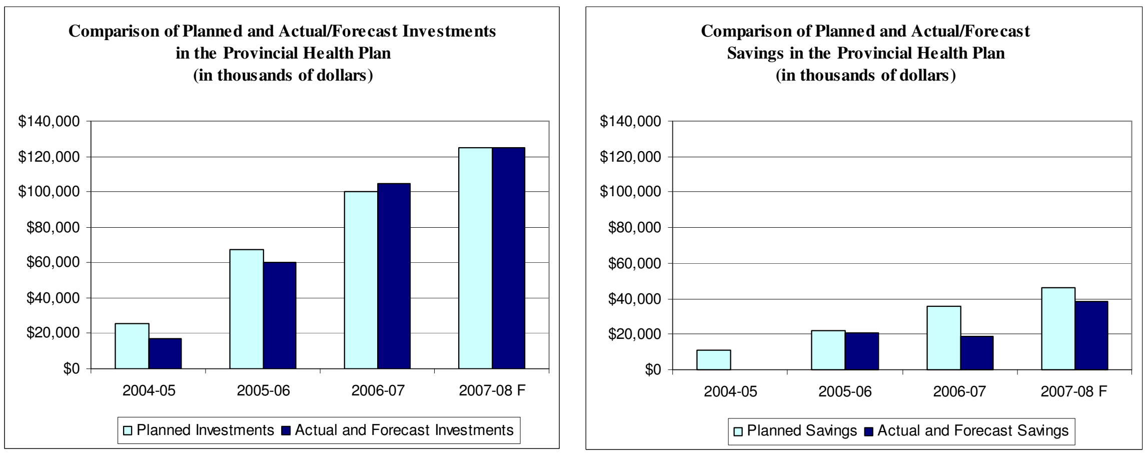
h. the policy framework, parameters and standards for the consolidation of clinical and non-clinical services provided by regional health authorities;

i. a comprehensive financial plan that includes a statement of how material and human resources, including but not limited to, financial resources, are to be allocated to meet the provincial health plan; and

j. any other matter prescribed by regulation.

The first Provincial Health Plan prepared under this Act covered the period 2004 to 2008. This plan identified some $125 million in new investments,[10] and targeted total savings of $46 million on an annualized basis by 2008. Based on information provided by the Department of Health, by the end of 2006-07 the Department will have invested $104.8 million, approximately $4.6 million more than had been planned for the first 3 years of the plan, but will have only realized $18.8 million of the planned $35.8 million in savings expected through 2006-07. Figure 9-1 shows the cumulative planned and actual/forecast investments and savings related to the Provincial Health Plan 2004-2008.

Figure 9-1 Comparison of Planned and Actual/Forecast Investments and Savings from the Provincial Health Plan

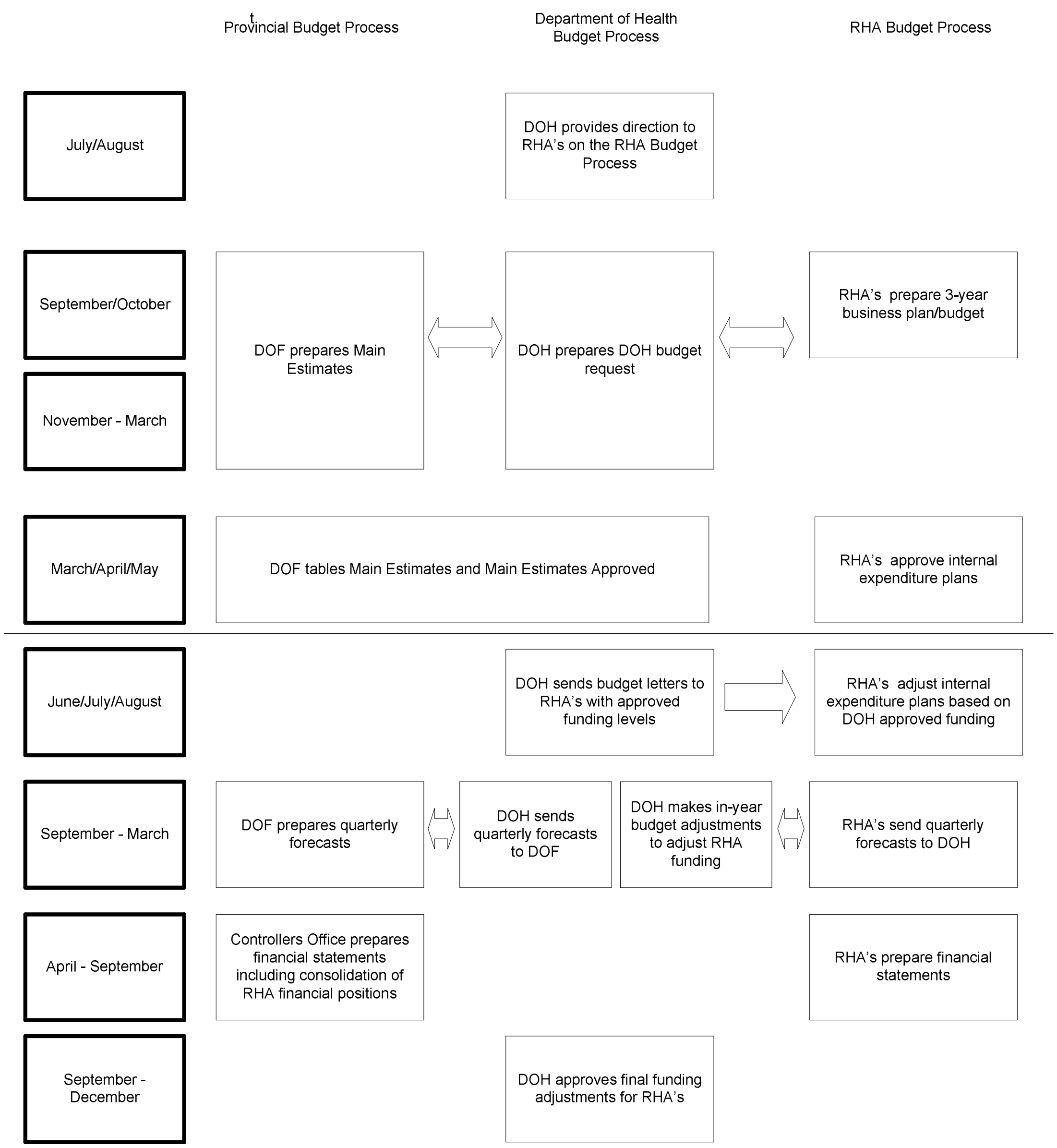


[10] These investments and targeted savings relate to the full range of programs the Department of Health is responsible for, including, but not limited to, the RHAs.

9.2.4 Business Planning, Budgeting and Financial Reporting for RHAs

Figure 9-2 provides an overview of the business planning and budgeting process related to RHAs.

Figure 9-2 Overview of the Business Planning, Budgeting and Financial Reporting Processes related to RHAs



Department of Finance Budget Targets

In the fall of each year, the Department of Finance initiates the government-wide business planning and budgeting process by requesting Departments prepare business plans and budgets based on the assumptions provided by the Department of Finance. For the planning process related to the 2006-07 fiscal year, the Department of Health was advised they should plan assuming a 6% increase in funding, including increases related to negotiated wage settlements. As shown in Table 9-1, the actual increases in Estimates for Department of Health over the past 6 years have typically been greater than 6% with an average annual growth rate of 7.6%.

Table 9-1 Comparison of Department of Health Expenditures Estimates

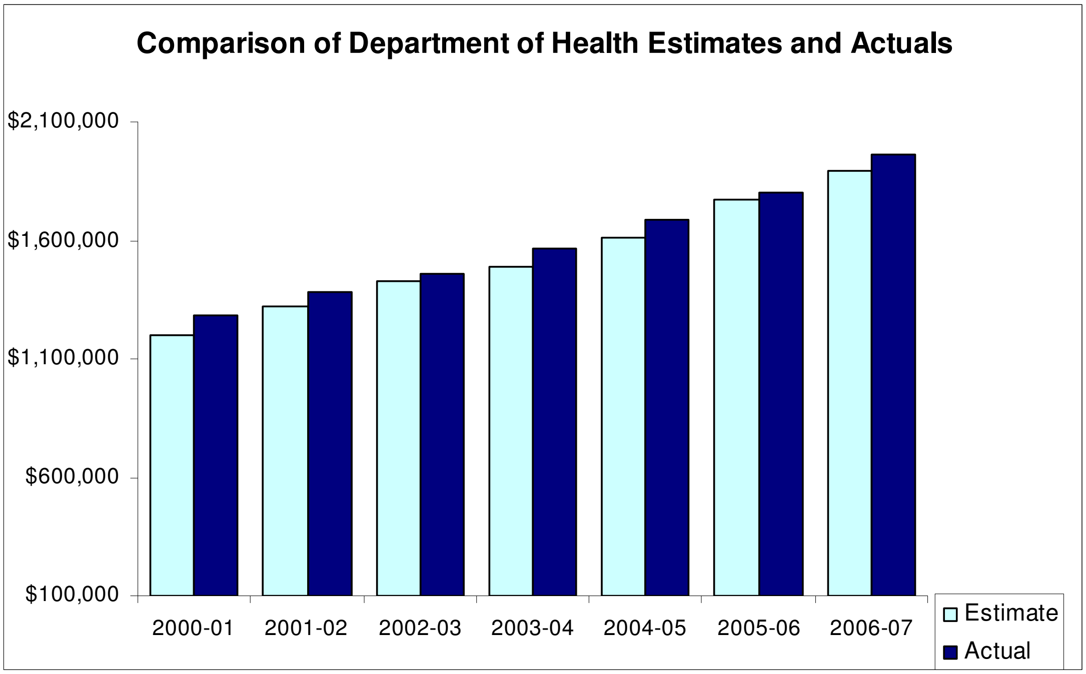
	1999-00 Estimate	2000-01 Estimate	2001-02 Estimate	2002-03 Estimate	2003-04 Estimate	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Total	$ 1,092.4	$ 1,196.6	$ 1,324.0	$ 1,428.7	$ 1,487.1	$ 1,609.7	$ 1,774.2	$ 1,896.8
Growth		9.5%	10.6%	7.9%	4.1%	8.2%	10.2%	6.9%

Department of Health Business Planning and Budgeting

The Department of Health undertakes its planning process in parallel with the Department of Finance planning process.

Using multi-year business plans from the RHAs, and other information related to changes to health programs, services and costs, the Department of Health prepares a summary of its request for funding. Typically, this request is in excess of the budget target provided by the Department of Finance at the start of the government business planning and budgeting process in part because Department of Health's actual spending typically exceeds the Estimate provided to the Department of Health as show in Figure 9-3 below.

Figure 9-3 Comparison of Department of Health Estimates and Actuals



Through a series of meetings between Department of Finance and Department of Health Senior Officials and Ministers, a budget allocation for Department of Health programs is determined to be included in the Main Estimates. The Minister of Health and Department of Health officials then determine the allocation of this Department-wide target to various programs, including the allocation to the RHAs.

As shown in Table 9-2 below, the Estimates for Hospital Services and Mental Health, the two largest program components of RHA funding, have typically grown by 3% to 11% annually with the average annual growth rate being 7.0%.

Table 9-2 Comparison of Hospital Services and Mental Health Estimates

	1999-00 Estimate	2000-01 Estimate	2001-02 Estimate	2002-03 Estimate	2003-04 Estimate	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Total	$ 678.5	$ 742.2	$ 820.1	$ 874.4	$ 899.7	$ 962.4	$ 1,067.9	$ 1,128.2
Growth		9.4%	10.5%	6.6%	2.9%	7.0%	11.0%	5.6%

9.2.6 RHA Business Planning, Budgeting and Financial Reporting Requirement for Three-Year Plans

Section 32 of the Regional Health Authorities Act indicates the RHA must prepare, in accordance with the timelines and form outlined by the Minister of Health, a business plan for a three-year period that includes:

a. the principles upon which the provision of health services by the regional health authority are to be based;

b. the objectives and priorities of the regional health authority for the provision of health services to meet the health needs in the health region and, where applicable, to meet the health needs of persons in other parts of the Province;

c. the health services to be delivered and administered by the regional health authority, and where the services are to be provided;

d. the nature and scope of any basic or applied research initiatives in relation to health care and health services;

e. the programs for training of persons in the medical and other health professions, including practice settings for the training of health professionals;

f. the means by which persons outside the region will be able to access the provincial programs for the provision of health services that are delivered by the authority;

g. the methods by which it will measure its performance in the delivery and administration of health services;

h. the initiatives respecting the delivery of health services that will involve the spending of money derived from foundations, trusts or other funds over which the regional health authority exercises powers and discharges responsibilities of a fiduciary or other nature;

i. any commercial arrangements or ventures in which the regional health authority participates or proposes to participate;

j. a comprehensive financial plan, which shall include

    i. a statement of how human and material resources, including financial resources, will be allocated to meet the objectives and priorities of the regional health authority;

    ii. a statement of how the authority proposes to eliminate or reduce a deficit, if it has one; and

    iii. the details of all investments held by the authority, or on its behalf; and

k. any other matter prescribed by regulation.

Business Planning Template and Directions

The Department of Health initiates the RHA business planning process in late summer by sending the RHAs direction with respect to the timelines and form for the RHA business plan submission, along with broad direction with respect to the assumptions that should be used for the submission of the business plan.

Until 2005, RHAs prepared annual business plans that addressed only the upcoming fiscal year. In 2005, the Department of Health introduced an annual business plan template used by the RHAs to create three-year business plans for 2006-07, 2007-08, 2008-09 as suggested in the enabling legislation. This multi-year business planning template, which is updated annually, requires the RHAs to submit a range of information, including:

- Location of various Hospital Intramural and Community Services;
- Personnel counts;
- Statement of Operations (revenues and expenses);
- Statement of Operations for Board Activities;
- Capital Equipment Plan (equipment \$5,000 to \$100,000 and equipment over \$100,000);
- Long Term Capital Assets Plan;
- Summary of Costs of New Initiatives, Enhancements and/or Reallocations with Current Funding Levels;
- Summary of Costs of New Initiatives, Enhancements and/or Reallocations Requiring Additional Funding; and
- Research Initiatives.

The business plan template does not require RHAs to submit information related to projected activity, statistics, workload or outcomes.

The directions for completion of the multi-year business planning template to support planning for the 2006-07 budget and the 2007-08 budget were provided to the RHAs on July 29, 2005 and August 21, 2006 respectively. In both years, these directions also indicated the business plans assume revenues from the Department of Health would increase by a notional 5% (based on approved funding by the Department of Health), including the wage bill and capital financing would be consistent with that received in recent years.

The budget targets (last year's budget plus 5%) provided to RHAs by the Department of Health do not reflect the fact that RHAs have been operating at expenditure levels that exceed their funding from the Department of Health. While the Department of Health collects a broad range of activity, statistical, workload and financial information from RHAs and reports these in the Annual Reports on Hospital Services, the Department has not created clinical services plans or other standards that provide guidance to the RHAs with respect to the volumes of activities or workload expected to be provided or occur for given levels of funding. Budget targets are therefore not supported by assumptions about the volume of activity (patient days, numbers of tests/procedures), or workload.

Business Planning and Budgeting at the RHA

Each RHA uses a slightly different approach to internal business planning and budgeting for its organization. Some RHAs use a bottom-up approach, where each manager with budget responsibility is required to identify his or her expenditure expectations for the upcoming three years based on prior year's spending levels and anticipated utilization and activity. Some RHAs use a more top-down approach, where budget managers are asked to identify cost-drivers or pressures (new programs, expected changes in utilization and activity, impacts of new physicians or services, etc.) and these are incorporated into a business plan and budget at an organization-wide level.

Most RHAs prepare three-year business plans building on current spending levels (adjusted in some cases for expected changes in utilization and activity) inflated for agreed cost escalators. As a result, as shown in Table 9-3 below, the financial request for hospital services funding submitted by RHAs exceeds the budget target directive provided by the Department of Health. This difference between the requested funding and the budget target is approximately equivalent to the RHAs' deficits in the current year (2005-06 cumulative deficits for RHAs were $32.9 million) and estimated annual growth in hospital spending of 4% (approximately $52 million).

Table 9-3 Comparison of RHA Target to RHA Request for Hospital Services for 2006-07

RHA	DOH Target 2005-06 Estimate inflated by 5%	RHA Request from Business Plan	Difference Request less Target	Percentage Request less Target
1B - Beauséjour	114,056,643	128,394,651	14,338,008	12.6%
1SE - South East	144,934,718	155,701,700	10,766,982	7.4%
2 -Atlantic Saint John	250,468,573	271,222,127	20,753,554	8.3%
3 - Fredericton	175,690,580	186,760,326	11,069,746	6.3%
4 - Edmundston	70,289,662	77,677,812	7,388,150	10.5%
5 - Campbellton	53,078,435	56,886,260	3,807,826	7.2%
6 - Acadie -Bathurst	105,809,499	117,300,047	11,490,548	10.9%
7 - Miramichi	52,206,528	57,172,308	4,965,780	9.5%
All RHAs	966,534,637	1,051,115,231	84,580,594	8.8%

The business plan template provided by the Department of Health indicates the RHA multi-year business plan should provide action plans on how the RHA will address any deficit within the time period covered by the business plan. RHAs do not, however, identify action plans to address any deficit in their business plans.

The three-year business plans developed in each RHA are reviewed with the RHA Board, and the Board approves the business plan for submission to the Department of Health. This approved business plan is referred to as the "approved (internal) expenditure plan" within the RHA. The "approved (internal) expenditure plan", less any funding requested for new programs, is typically used as the basis for establishing internal RHA budgets at the beginning of the fiscal year. These internal budgets are used to hold RHA managers accountable for operating their programs and services. The amount included in the three-year business plans related to new programs is typically held in a separate account and not allocated to budget managers until it is approved by the Department of Health.

Review and Approval of RHA Business Plans

RHA multi-year business plans are expected to be submitted to the Department of Health by October 31. When the Department of Health receives the plan they convene a Review Team consisting of 10 members representing different programs within the Department. The Review Team members receive a copy of each RHAs' business plan, which they are expected to review prior to the Review Team meetings. At the Review Team meetings, each RHAs' business plan is reviewed to develop recommendations to the Department's Senior Management Team with respect to approval of the business plans.

Section 32(5) of the Regional Health Authorities Act indicates the Minister of Health may:

> "*(a)* approve a proposed regional health plan as submitted, subject to the condition that the approval of the component of the plan that relates to the financial plan shall be only in respect of the forthcoming fiscal year,
>
> or
>
> *(b)* refer a proposed regional health plan back to the regional health authority for further action, with any directions the Minister considers appropriate."

The Department of Health issues budget letters approving the funding level for the RHAs in late summer, after the provincial budget is approved. The budget approval letters for 2006-07 issued by the Minister to the RHA Chairs were sent on July 18, 2006. The budget approval letters for 2006-07 issued by the respective program Directors at the Department of Health to the RHA CEO's were sent on July 28, 2006. As a result, RHAs were not aware of approved funding levels until approximately 1/3 of the fiscal year had expired and by the time the approved funding is entered into the internal budget system at the RHA in early fall, almost half the fiscal year has expired.

The budget approval letters do not explicitly accept or approve the multi-year business plans submitted by the RHAs. The RHA Act indicates in Section 31 (b) that a regional health authority may provide health services only where the services are included in a plan approved by the Minister. Because the multi-year business plans are not formally approved, RHAs have interpreted this to mean they are not able to make changes to their services to allow them to operate within the approved funding levels.

While the RHA multi-year business plans identify funding requirements for a three-year period, the RHAs do not get any direction with respect the funding levels they can expect for future years.

Monitoring and Reporting RHA Financial Performance

The budget approval letter sent to the RHA Chairs indicates the RHA must submit the internal distribution of the current approved spending level plus anticipated Federal funds for the fiscal year through electronic submission. Because RHAs hold managers accountable to their internal expenditure plan, the requirement to submit an electronic version of the Department of Health approved budget results in the RHA having two budgets to report against through the year – their internal budget and the Department of Health approved budget.

In addition to submitting this financial information, each RHA submits financial information on a monthly basis, and a forecast of its deficit on at least a quarterly basis. While some RHAs submit a forecast deficit including both the expected expenditure level and the expected deficit (difference between budget and expected expenditure level), some only provide a forecast of expected deficit. As a result, the Department of Health cannot validate that the RHA and the Department of Health are using the same budget at the basis for calculating the expected deficit.

As Table 9-4 below shows, RHA forecast deficits are typically more conservative at the end of the first quarter[11].

Table 9-4 RHA Forecasted Deficits

(in units of dollars)

RHA	2005-06 Forecast Deficit Q2	2005-06 Forecast Deficit Q3	2005-06 Actual Deficit (less amortization)	2004-05 Forecast Deficit Q2	2004-05 Forecast Deficit Q3	2004-05 Actual Deficit (less amortization)
1B - Beauséjour	$ (8,664,469)	$ (7,287,066)	$ (6,456,799)	$ (7,982,613)	$ (7,550,290)	$ (4,584,794)
1SE - South East	(6,452,336)	(6,556,427)	(6,326,211)	(5,332,696)	(3,572,847)	(745,824)
2 -Atlantic Saint John	(11,427,593)	(6,707,947)	(2,274,480)	(9,426,403)	(5,106,900)	(2,747,324)
3 - Fredericton	(6,235,000)	(5,405,000)	(5,074,872)	(5,150,000)	(5,096,000)	(2,816,068)
4 - Edmundston	(3,370,000)	(3,773,000)	(378,706)	(2,677,280)	(2,347,000)	(198,758)
5 - Campbellton	(1,452,825)	(2,171,456)	(2,360,489)	(988,956)	(474,002)	(24,849)
6 - Acadie -Bathurst	(6,307,109)	(7,507,150)	(8,245,048)	(4,531,457)	(4,300,483)	(3,485,063)
7 - Miramichi	(1,368,282)	(1,256,754)	(1,801,012)	(1,100,000)	(904,103)	(309,954)
All RHAs	$ (45,277,614)	$ (40,664,800)	$ (32,917,617)	$ (37,189,405)	$ (29,351,625)	$ (14,912,634)

In addition to providing a forecast of the expected deficit, each RHA provides a written variance analysis explaining the causes of the expected deficit. Because the RHA internal expenditure plan is based on the previous year's spending base, the most significant cause identified for RHA deficits is the gap between the previous year's actual expenditures and the current year approved funding level. For example, of the forecasted deficit of $46 million for RHAs reported in October 2006 shown in Table 9-5 below, $29.1 million (64%) is attributed to the deficit of 2005-06.

[11] Because the Department of Health tracks forecast deficits, not forecast expenditures, it is not possible to determine the extent to which the changes to the forecast deficit are a result of in-year adjustments to approved funding.

Table 9-5 Estimate and Forecast for Hospital Services for 2006-07

(in units of dollars)

RHA	Hospital Services Estimate 2006-07	Hospital Services Forecast 2006-07	Variance Estimate less Forecast	Percentage Variance
1B - Beauséjour	$ 125,575,148	$ 135,282,471	$ (9,707,323)	(7.7%)
1SE - South East	156,944,462	165,349,796	(8,405,334)	(5.4%)
2 -Atlantic Saint John	266,960,962	273,960,962	(7,000,000)	(2.6%)
3 - Fredericton	185,470,222	191,570,222	(6,100,000)	(3.3%)
4 - Edmundston	72,758,901	77,471,317	(4,712,416)	(6.5%)
5 - Campbellton	73,089,964	73,523,079	(433,115)	(0.6%)
6 - Acadie -Bathurst	106,655,947	115,235,947	(8,580,000)	(8.0%)
7 - Miramichi	53,086,928	54,135,928	(1,049,000)	(2.0%)
All RHAs	$ 1,040,542,534	$ 1,086,529,722	$ (45,987,188)	(4.4%)

The Department of Health has two staff members who monitor and analyse financial information related to RHAs. They maintain regular dialogue with the RHAs with respect to actual and forecasted financial performance and receive quarterly financial information, including forecasts of expected annual revenues and expenditures. In addition, representatives from the Financial Services Division of the Department of Health meet at least three or four times a year with each RHA to understand its year to date expenditures, and to discuss its expected financial results.

In addition to the regular dialogue between RHAs and the Department of Health related to actual and forecasts financial performance, the Assistant Deputy Minister, Corporate Services convenes a monthly meeting of the Vice-Presidents of Corporate Services of the RHAs to discuss financial performance and system-wide issues related to the RHAs.

While there is regular information sharing between the RHAs and the Department of Health related to the RHAs actual and forecasted financial performance, the Department of Health can only direct RHAs actual spending or changes to services to impact actual spending through the Minister of Health.

RHA Financial Results

RHAs have consistently spent in excess of approved budgets as shown in Table 9-6 below.

Table 9-6 Comparison of RHA deficits

(in unit dollars)

RHA	2003-04 Annual Deficit Adjusted	2003-04 % of adjusted revenues	2004-05 Annual Deficit Adjusted	2004-05 % of adjusted revenues	2005-06 Annual Deficit Adjusted	2005-06 % of adjusted revenues
1B - Beauséjour	$ (5,890,766)	4.75%	$ (5,826,066)	4.17%	$ (7,814,859)	5.15%
1SE - South East	(7,234,240)	4.70%	(1,421,248)	0.82%	(6,613,558)	3.57%
2 -Atlantic Saint John	(3,411,067)	1.24%	(2,296,600)	0.77%	(4,486,876)	1.42%
3 - Fredericton	(4,622,731)	2.50%	(2,885,943)	1.40%	(5,637,101)	2.58%
4 - Edmundston	497,413	0.69%	955,426	1.20%	1,095,346	1.27%
5 - Campbellton	(172,465)	0.23%	(112,585)	0.14%	(937,672)	1.13%
6 - Acadie -Bathurst	(5,112,763)	4.70%	(5,869,527)	4.81%	(11,760,564)	9.30%
7 - Miramichi	(690,643)	1.23%	(268,304)	0.44%	(1,732,640)	2.69%
All RHAs	$ (26,637,262)	2.54%	$ (17,724,847)	1.53%	$ (37,887,924)	3.07%

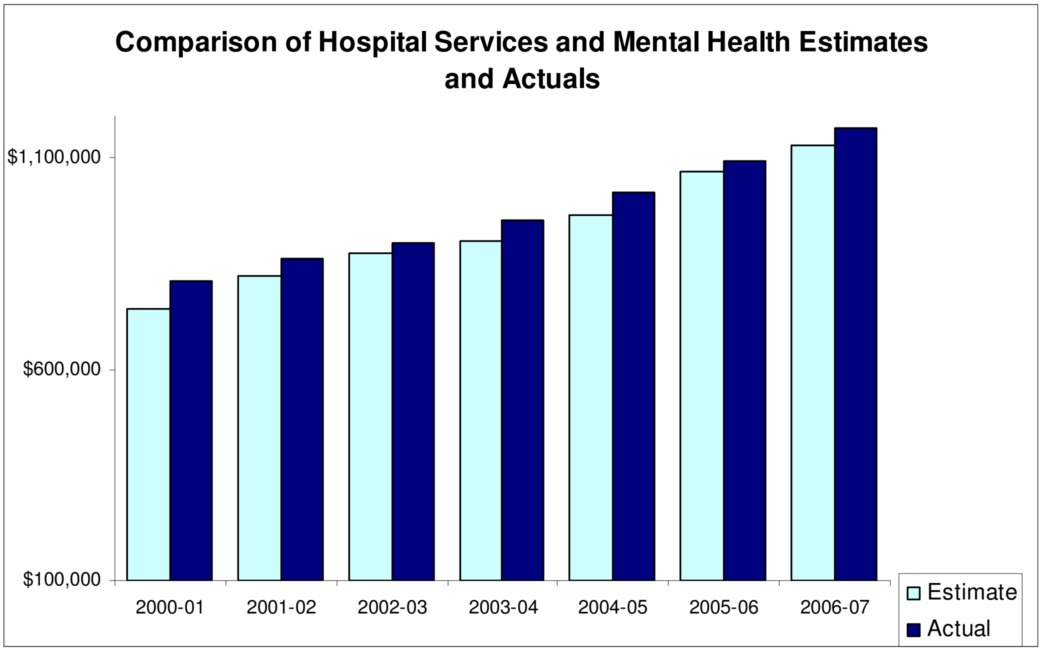
The Regional Health Authority Act indicates a Regional Health Authority shall not accumulate a deficit.

Traditionally, the Department of Health has provided a working capital grant to RHAs to finance the cash-flow implications of its deficits. Before April 1, 2004, these working capital grants were recorded as they were received. In fiscal year 2004-05, the Department of Health funded 100% of the RHAs' deficits for the fiscal years 2001-02 and 2002-03, and 50% of the RHAs' deficits for fiscal year 2003-04. In fiscal year 2005-06, the Department of Health funded the remaining 50% of deficits for fiscal year 2003-04. As a result, the health system was effectively fully funded up to the end of fiscal year 2003-04.

Beginning in fiscal year 2004-05, the Department of Health indicated that working capital grants should be recorded as revenues on the RHAs audited financial statements in the year they occur – essentially, the working capital grants have become funding for the RHA deficits.

While the Department of Health has essentially funded RHA deficits to this point, the approved budgets for RHAs do not reflect their actual spending levels. As shown in Figure 9-4 below, the Estimates for Hospital Services and Mental Health (the two largest program components of RHA funding) have only been marginally greater than the actual spending for these programs in the prior year. As a result, RHAs operate through the year with a budget that does not reflect the actual cost structure at the beginning of the year.

Figure 9-4 Comparison of Hospital Services and Mental Health Estimates and Actuals



9.2.7 Recurring Nature and Causes of Regional Health Authority Deficits

Outlined below are the key issues identified through the review of the Business Planning, Budgeting and Financial Management Processes that contribute to the recurring nature and causes of RHA deficits.

Funding targets inconsistent with the current services and service delivery model in the Health System	As shown in Figure 9-4, budget targets for the upcoming year are based on prior year approved budgets, and do not reflect the actual spending levels of the RHAs. That is, the base level of funding represented by the budget targets is not consistent with the service delivery models and levels of activity in the system.
Budget targets are not supported by assumptions of activity or workload	Budget targets are not supported by assumptions about levels of activity or workload to be provided or occur within the budget target level. Therefore, RHAs have no basis on which to assess whether business plans are consistent with expected levels of activity or workload.

RHAs do not submit action plans to address differences between target funding and requested funding

The RHA business plan template instructions indicate RHAs should provide an action plan on how to address any deficit within the time period covered by the RHA business plan, but the templates do not include a specific schedule by which this action plan should be provided. Further, RHAs do not include plans identifying the possible changes to services or service delivery models to operate within budget targets.

RHA internal budgets exceed Department of Health funding targets

The internal expenditure plans RHAs use for internal budgets are based on projected costs as reported in the business plan, not on the budget target provided by Department of Health. As a result, RHA budget managers manage, and are held accountable to, a budget that is in excess of the Department of Health budget target.

RHA business plans are not approved

The Minister of Health does not approve business plans explicitly when budget approval letters are provided to the Chair of the RHA, respectively. As a result, RHAs do not make changes to services or service delivery plans to operate within the budget target.

RHA funding approvals are not received until 1/3 of the fiscal year is complete

The Department of Health does not provide confirmation of RHA funding until approximately 1/3 of the fiscal year is complete, leaving less time for the RHA to enact changes to services or service delivery models to operate within approved funding levels.

Multi-year funding approval or direction is not provided

Multi-year funding approvals or directions are not provided to the RHAs to allow proactive planning to allow the RHA to operate within Department of Health funding targets.

No in-year direction is provided

Throughout the year, RHAs report forecasted deficits, but do not formally propose plans or service delivery changes to address these deficits. Similarly, the Department of Health does not provide any direction with respect to making changes to allow the RHA to operate within approved funding levels.

RHA deficits are funded at year end in the form of working capital grants but the funding base is not adjusted

The working capital grants provided by the Department of Health to RHAs at the end of the year essentially fund the RHA deficit but these working capital grants are not built into the funding base for the subsequent year. As a result, RHAs essentially operate through the year with a funding level that does not reflect their actual cost base.

9.3 Recommendations

24 The Province should develop an updated Provincial Health Plan, including a clinical services plan. This planning process should evaluate the cost of providing the current health system, and establish funding targets based on the levels of activity and workload required to support the Province's objectives for the health system, as identified in the updated Provincial Health Plan.

25 The Department of Health business planning process should be revised to provide direction to RHAs about the changes to their services and service delivery models that should be undertaken to allow the RHAs to operate within their approved levels of funding. This would allow RHAs to develop internal plans and budgets that are consistent with the Department of Health approved funding levels.

26 Consideration should be given to having the Department of Finance provide the Department of Health and RHAs with multi-year funding targets for business planning purposes. This would permit the introduction of changes to services and service delivery models to minimize disruptions to the system and to citizens.

10. Out of Province Hospital Payments Review

To review, comment and make recommendations regarding the repetitive nature and cause of Out of Province Hospital Payment deficits.

10.1 Procedures

Based on information from discussions with Provincial representatives and a review of documents provided by the Province, Grant Thornton LLP:

- documented the Province's policy on Out of Province Hospital payments;
- documented the current budgeting process for Out of Province Hospital payments and the financial amounts for Out of Province Hospital payments included in the 2006-07 Main Estimates;
- documented the actual amount of Out of Province Hospital payments for the past five years;
- documented key assumptions and future commitments/contingencies related to Out of Province Hospital Payments and the potential impact of these on the expected financial position of the Province in 2006-07 and in future years; and
- commented on the financial risks related to the current policy for Out of Province Hospital Payments.

10.2 Background

10.2.1 Basis for Out of Province Hospital Payments

Under the Canada Health Act, residents of any province or territory (jurisdiction) are entitled to receive insured services in another jurisdiction and these services must be reimbursed by the patient's home jurisdiction. The rates at which these services are reimbursed to the host jurisdiction by the patient's home jurisdiction are determined through the Hospital Reciprocal Agreement. Under this agreement, insured hospital services are payable at the approved rates of the host jurisdiction or as otherwise agreed upon by the parties involved or by the Interprovincial Health Insurance Agreements Coordinating Committee (IHIACC).

For some procedures and services, such as chemotherapy and defibrillator-pacemaker replacement, the providing facility is permitted to invoice for the actual costs of drugs or devices also.

New Brunswick, like all other provinces and territories in Canada, participates in the Hospital Reciprocal Agreement with other provinces and territories.

10.2.2 Basis for Out of Province Medical Services Payments

Payments of Out of Province/territory claims for medical services provided by a licensed physician to residents of the other jurisdiction are determined through the Medical Reciprocal Billing Agreement. Where a reciprocal billing agreement exists, an insured medical service is payable at the approved rate of the host jurisdiction. New Brunswick participates in the Medical Reciprocal Billing Agreement with provinces and territories (except Quebec).

The Estimates related to these payments and the actual expenditures are included in the Estimates for Medicare expenditures and therefore are not included in this analysis.

10.2.3 Rate Setting for Out of Province Hospital Payments

The Interprovincial Health Insurance Agreements Coordinating Committee (IHIACC) oversees the application of the Reciprocal Agreements related to Out of Province hospital services. All 13 provincial/territorial governments are represented on the committee. It meets annually to establish rates for services delivered to Out of Province patients under the Reciprocal Agreement. Rates are typically determined in the fall for the following fiscal year.

10.2.4 Applicable Services

New Brunswick residents generally receive services in other jurisdictions based on:

- referrals made by physicians (either based on patient or physician preference) to programs/services or providers outside of New Brunswick; and
- services not being available in New Brunswick.

In some cases, New Brunswick residents receive services outside of the province when they experience an emergency situation while traveling.

10.2.5 Process for Out of Province Hospital Payments

Payments for hospital services provided to New Brunswick residents out of province are made based on invoices prepared by other jurisdictions and forwarded monthly to the New Brunswick Department of Health. These payments are processed bi-weekly. The Reciprocal Agreement allows jurisdictions to invoice up to 12 months after services are provided. As a result, the Department of Health receives invoices for Out of Province services well into the following fiscal year.

10.3 Profile of Out of Province Hospital Payments

10.3.1 Total Payments for the Past Five Years

As shown in Table 10-1 below, actual expenditures for Out of Province Hospital payments increased by a total $22.755 million between 2001-02 and 2005-06 or an average of $5.7 million annually.

Table 10-1 Actual Out of Province Payments for 2001-02 to 2005-06

(in thousands of dollars)

	2001-02 Acutal	2002-03 Actual	2003-04 Actual	2004-05 Actual	2005-06 Actual
In-Patient	$ 16,899.1	$ 19,946.4	$ 25,058.0	$ 34,096.0	$ 33,580.7
High Cost Procedure	5,257.3	6,308.3	4,103.2	5,224.5	5,483.4
Sub-Total In-Patient	22,156.4	26,254.7	29,161.2	39,320.5	39,064.1
Out-Patient	4,653.3	6,204.3	5,192.8	6,203.9	10,501.1
Total OOP Hospital Payments	**$ 26,809.7**	**$ 32,459.0**	**$ 34,354.0**	**$ 45,524.4**	**$ 49,565.2**

In percentage terms, this represents growth of between 5.8% and 32.5% annually as shown in Table 10-2 below.

Table 10-2 Growth in Out of Province Payments from 2001-02 to 2005-06

	2002-03 Actual	2003-04 Actual	2004-05 Actual	2005-06 Actual
In-Patient	18.0%	25.6%	36.1%	-1.5%
High Cost Procedure	20.0%	-35.0%	27.3%	5.0%
Sub-Total In-Patient	18.5%	11.1%	34.8%	-0.7%
Out-Patient	33.3%	-16.3%	19.5%	69.3%
Growth in OOP Hospital Payments	21.1%	5.8%	32.5%	8.9%

As Table 10-3 shows, the percentage changes in inpatient ward rates[12] and rates for various outpatient services have ranged from 2% to 13% on average over the past five years[13].

[12] Ward rate increases become effective on July 1.

[13] Rates for Outpatient services did not increase between 1998 and 2004 but were adjusted significantly effective April 1, 2004.

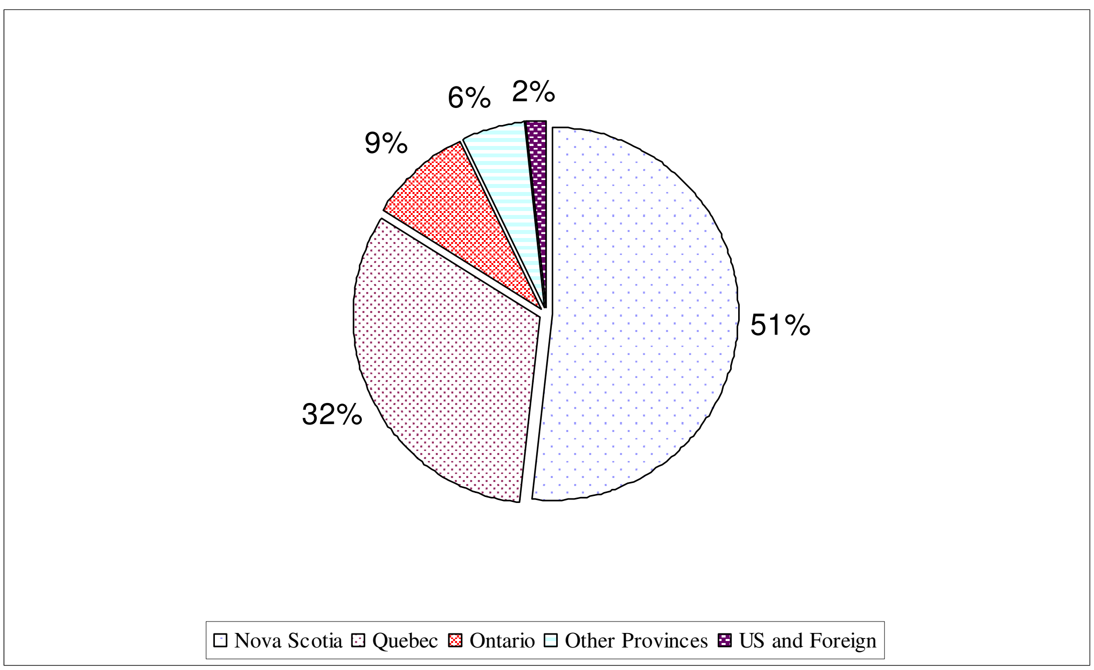
Table 10-3 Percentage Changes in Inpatient and Outpatient Services Rates

	April-02	April-03	April-04	April-05	April-06	Changes over 5 Years	Average Annual Growth
In-Patient Ward Rates	4.0%	5.0%	3.3%	3.2%	3.9%	19.4%	3.9%
Standard Out-Patient Visit	0.0%	0.0%	39.1%	3.3%	3.8%	46.2%	9.2%
Day Surgery	0.0%	0.0%	0.0%	58.8%	3.9%	62.7%	12.5%
Hemodialysis	0.0%	0.0%	50.0%	3.3%	3.8%	57.1%	11.4%
Computerized Axial Tomography	0.0%	0.0%	50.0%	3.3%	3.9%	57.2%	11.4%
Referred in Lab Specimens	0.0%	0.0%	15.6%	2.7%	2.6%	21.0%	4.2%
Cancer Chemotherapy Visit					3.9%	3.9%	
Lithotripsy	0.0%	0.0%	27.0%	3.1%	3.9%	34.1%	6.8%
MRI	0.0%	0.0%	4.6%	3.2%	4.0%	11.8%	2.4%
Radiotherapy	0.0%	0.0%	37.1%	3.3%	4.0%	44.4%	8.9%

10.4 Payments by Province

As shown in Figure 10-1 below, Out of Province Payments are primarily related to services provided to New Brunswick residents at Nova Scotia health care facilities (51% of Out of Province Hospital Payments and approximately 70% of encounters) or health care facilities in Quebec (32% of Out of Province Hospital Payments). Out of Province Payments to Ontario represent 9% of total payments and payments to other jurisdictions and the United States represent 6% and 2% of total Out of Province Payments respectively.

Figure 10-1 Breakdown of Out of Province Payments for 2005-06 by Provider Province



In 2006, the Department of Health commissioned a study of Out of Province Payments aimed at understanding the nature of the changes in Out of Province Payment costs. As suggested by the comparison of increases in actual Out of Province Payment costs in Table 10-1 compared with rate increases in Table 10-3, increases in Out of Province Payment costs are not only driven by rate increases. The study indicated the total volumes of procedures has remained essentially stable over the three years considered in the study (2003 to 2005) and attributed the increase of Out of Province costs in excess of rate increases to:

- proportionally higher volumes of higher cost cases within case mix and longer lengths of stay; and
- increased prices associated with medical/surgical supplies, medications and pharmaceuticals which are paid in addition to the standard rates for services.

For example, this study identified that the proportion of Out of Province Payments related to cardiac surgery and cardiac catheterizations has grown from 5% of total inpatient Out of Province Payments in 2001-02 to 10% of total inpatient Out of Province Payments.

Table 10-4 Out of Province Payments for Specific Cardiac Procedures

(in units of dollars)

	2001-02	2002-03	2003-04	2004-05
Cardiac Surgery	811,182	932,585	2,122,235	3,026,959
Cardiac Catheterization	367,305	299,356	420,035	1,079,255
	1,178,487	1,231,941	2,542,270	4,106,214
Total Inpatient Out-of-Province Payments	$ 22,156,440	$ 24,456,800	$ 29,161,200	$ 39,320,500
Percentage of Inpatient Out-of-Province Payments for Specific Cardiac Procedures	5%	5%	9%	10%

The volume of cardiac surgery and cardiac catheterizations ("cardiac caths") has grown by 198% and 438% since 2001-02 as shown in Table 10-5. Cost per case for cardiac by-pass surgery has grown by 25% since 2002 and cost per case for cardiac caths has decreased by 45%.

Table 10-5 Service Volumes and Cost per Case for Specific Cardiac Procedures

(in millions of dollars)

	2001-02	2002-03	2003-04	2004-05	Three-year Growth
Service Volumes					
Cardiac By-pass Surgery	81	77	129	241	
Cardiac Catheterization	39	41	79	210	
Cost/Case					
Cardiac By-pass Surgery	$ 10,015	$ 12,112	$ 16,451	$ 12,560	
Cardiac Catheterization	$ 9,418	$ 7,301	$ 5,317	$ 5,139	
Growth in Service Volumes					
Cardiac By-pass Surgery		-5%	68%	87%	198%
Cardiac Catheterization		5%	93%	166%	438%
Growth in Cost/Case					
Cardiac By-pass Surgery		21%	36%	-24%	25%
Cardiac Catheterization		-22%	-27%	-3%	-45%

10.5 Budgeting and Financial Management

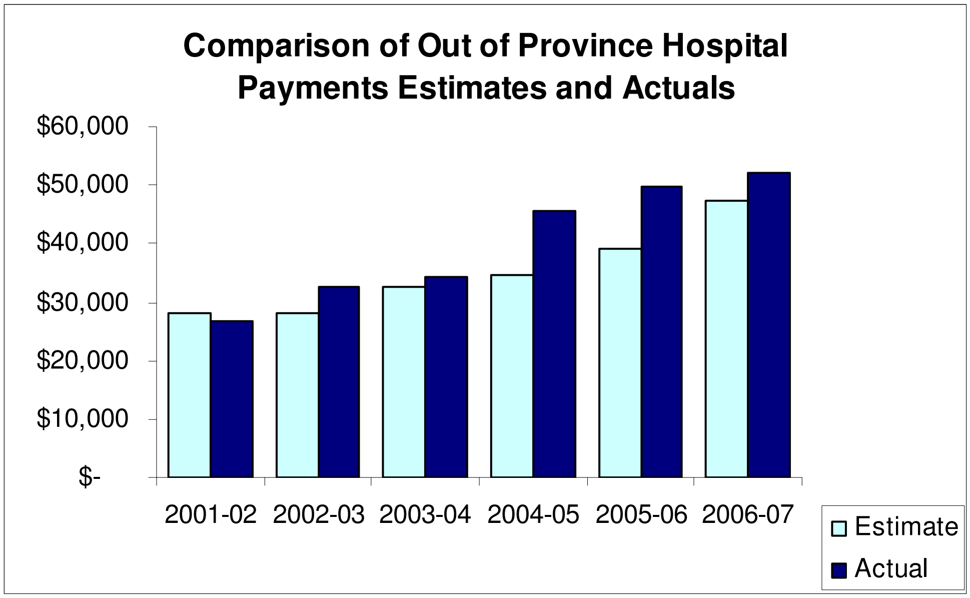
10.5.1 Budget Process

The Department of Health indicates that the budget for Out of Province Hospital Payments is developed by projecting the subsequent year costs based on:

- the real increases in costs for programs and for major provinces for the past three years and the estimated increase in costs in the current year; and
- estimated rate increases.

As shown in Figure 10-2, the increase in the Estimate for Out of Province Hospital Payments has not anticipated growth in Out of Province Payments and in the past years has in fact anticipated a decline in Out of Province Payments.

Figure 10-2 Comparison of Out of Province Hospital Payments Estimates and Actuals



10.5.2 Financial Management

The Canada Health Act allows Canadians to receive certain health services in any jurisdiction and requires the home jurisdiction's health insurance cover the cost. New Brunswick does not have any procedures in place to pre-approve Out of Province services (services provided out of country must receive pre-approval from the Medicare Operations Medical Consultant but these payments represent 1.7% of total Out of Province Payments). Aside from monitoring the actual expenditures related to Out of Province Payments, the Department of Health does not perform any regular analysis on the nature of services provided Out of Province and/or the reasons New Brunswick residents receive services Out of Province.

10.6 Forecast 2006-07

The expected deficit related to Out of Province Payments is $4.846 million as shown in Table 10-6.

Table 10-6 Expected Fiscal Results related to Out of Province Payments

(in thousands of dollars)

	2005-06 Actual	2006-07 Main Estimates	2006-07 Forecast	2006-07 Variance
Out of Province Hospital Payments	$ 49,565	$ 47,213	$ 52,059	$ (4,846)

10.7 Material Variances from Main Estimates

The forecast actual spending for Out of Province Hospital Payments represents a 5% increase over last years' spending. This is less than the typical rates of growth for Out of Province Hospital Payments shown in Table 10-2. The declining rate of growth is in part attributable to the introduction of a new cardiac cath lab that will address some of the demand that was previously served outside the Province.

The practice of providing Estimates that allow for little or no rate or utilization increases as shown in Table 10-7 has resulted in recurring annual deficits related to Out of Province Hospital Payments.

Table 10-7 Surplus / (Deficit) related to Out of Province Payments for the Past 5 Years

(in thousands of dollars)

	2001-02	2002-03	2003-04	2004-05	2005-06
Estimate	$ 28,143.0	$ 28,143.0	$ 32,413.0	$ 34,513.0	$ 39,213.0
Acutal	26,809.7	32,459.0	34,354.0	45,524.4	49,565.2
Surplus(Deficit)	$ 1,333.3	$ (4,316.0)	$ (1,941.0)	$ (11,011.4)	$ (10,352.2)

Because the Department of Health does not develop the Estimates for Out of Province Payments at the level of estimated number of procedures or estimated rates, it is not possible to attribute the deficits to a variance related to volume of services or rates.

10.8 Risks and Uncertainties related to the 2006-07 Forecast

Financial forecasts are based on assumptions about future events and circumstances and actual events and circumstances may vary from these assumptions. As a result, the actual fiscal results and financial position of the Province at March 31, 2007 may vary from the forecast position provided in this report.

10.8.1 Uncertainty related to the Methods for Forecasting

The forecast for Out of Province Hospital Payments is prepared by the Department of Health based on its knowledge of rate increases, changes to volume of claims and changes to volume of days of stay. This information is applied to two methods of forecasting:

- an analysis of five year cumulative payments applied to current year to date expenditures by province, and by type of payment (e.g. Inpatient excluding High-Cost procedures, High Cost-Procedures, Outpatient)[14]; and
- a comparison of current year cumulative payments to last year's cumulative payments.

[14] This method of forecasting has only been used since last fiscal year.

Owing to the relative immaturity of the forecasting method and the ability of jurisdictions to submit claims up to 12 months in arrears, the forecasting for Out of Province Hospital Payments contains risks and uncertainties that could result in the actual deficit for 2006-07 being greater than forecast.

10.8.2 Impact of the new Cardiac Catheterization Lab

The actual growth rate for Out of Province Hospital Payments is expected to be lower in 2006-07 than prior years based on the introduction of the Cardiac Cath lab in Saint John which came into operation in April 2006. This new service is expected to decrease the number of patients being sent out of province for cardiac cath procedures and related inpatient and high-cost procedures.

10.9 Implications beyond 2006-07

10.9.1 Provincial/Territorial Review of Out of Province Hospital Rate Setting Method

In December 2005, the Provincial/Territorial Deputy Ministers of Health established a Terms of Reference for a review and recommendations related to the:

- accuracy, equity and appropriateness of the methodology used for calculating billing rates for all insured services (specifically hospital services – inpatient and outpatient) covered by the inter-provincial reciprocal agreements, including the accuracy/quality and timeliness of data used to support these calculations;
- respective roles and relationships of the Conference of Deputy Ministers and IHIACC and its sub-committees in the approval process for inter-provincial rate changes and, more specifically, how this structure relates to other inter-provincial committees reporting to or governed by the Conference of Deputy Ministers; and
- alignment of inter-provincial rate changes with provincial/territorial budgetary decision making processes.

The committee overseeing the review was led by the Province of New Brunswick and the draft report was intended to be completed by March 15, 2006. The draft report has been completed but has not been shared with the Deputy Ministers and therefore was not available for inclusion in this review. However, the resulting recommendations related to the rate-setting formula are expected to result in continued and perhaps greater increases in rates for Out of Province Hospital Payments going forward.

10.9.2 Monitoring Out of Province Payments

Payments related to Out of Province Hospital Payments are currently monitored by Out of Province Hospital staff of the Department of Health. This monitoring focuses on the accuracy of invoices from other jurisdictions and trends in total expenditures. It does not include a review of trends related to the underlying nature of these services such as the types of procedures or services being provided to New Brunswick residents outside of New

Brunswick or any analysis of the reasons that New Brunswick residents are referred out of province for services. As a result, projections of future costs related to Out of Province Hospital Payments are subject to uncertainty because they are not informed by information and assumptions related to referral patterns.

10.9.3 Recurring Nature and Causes of Out of Province Hospital Payments Deficits

Outlined below are the key issues identified through the review of the Business Planning, Budgeting and Financial Management Processes related to Out of Province Hospital Payments that contribute to the recurring nature and causes of these deficits.

Budget targets are inconsistent with the current spending levels	As shown in Figure 10-2, budget targets for the upcoming year do not reflect the actual spending levels for Out of Province Hospital Payments. That is, the base level of funding represented by the budget targets is not consistent with the current levels of activity in the system and/or do not incorporate anticipated increases in rates.
Budget targets are not supported by assumptions of activity or workload	The Department of Health does not develop its budget estimates for Out of Province Hospital Payments based on assumptions about activity or workload but instead uses prior year's spending trends as the primary basis for developing the budget estimates for Out of Province Hospital Payments.
Department of Health does not monitor activity to understand or attempt to plan for referral trends	Department of Health monitors the number of claims and number of patient days per province per invoice but does not monitor activity related to the types and volumes of procedures that are referred outside the province to understand or attempt to plan for referral trends. In the summer of 2006, the Department developed a reporting model to indicate details about the types, volumes and cost of procedures that are performed outside of New Brunswick. This model is anticipated to be used to assess the last 5 years of actual experience and to monitor and understand referral trends.

10.10 Recommendations

27 The annual budgeting process for Out of Province Hospital payments should explicitly consider the approved rate increases set by the IHIACC, any known increases in facility-specific rates, and any other known changes in availability of services.

28 The Department of Health is encouraged to use the information from the new Out of Province Hospital Payments reporting model to monitor the nature of Out of Province services to better understand the underlying causes of increases in costs related to Out of Province Hospital Payments. While the Department cannot deny payment for residents who receive services Out of Province, analysis of the underlying nature of these services will provide the Department with better information to inform health services planning, and to influence health care service delivery in New Brunswick.

APPENDIX A
LIST OF INTERVIEWS RELATED TO THE INDEPENDENT REVIEW OF THE PROVINCE'S FINANCIAL POSITION

Interviewee
John Mallory Deputy Minister Department of Finance
Kim MacPherson Comptroller
Michael Ferguson Auditor General
Gordon Gillman ADM Corporate Services, Department of Health
Eric Beaulieu Financial Services, Department of Health
Byard Smith Director of Financial Services, Department of Health
Peter Kieley Department of Finance
Troy Mann Department of Finance
Sharon McFarlane NB Power
Jack Brown ADM, Community Services, Department of Health
Paul Jewett Office of the Auditor General
John Sinclair NBIMC
Dan Goguen NBIMC
Don Harrington Office of Human Resources
Conrad Ferguson Morneau Sobeco
Tom Maston Vice President Corporate Services and CFO, River Valley Health
Michael Chisholm Vice President Corporate Affairs and CFO, Atlantic Health Sciences Corporation
Allan Maher Steering Committee

Doug Tyler Steering Committee
Honourable Victor Boudreau Minister of Finance
Bernard Theriault Chief of Staff, Premier's Office
Allan Mongraw Vice President Corporate Services, South East RHA
Linda Currie CFO, South East RHA
Joey Caissie Vice President Finance and Corporate Services, Beauséjour RHA
Alain Béchard Comptroller, CFO, Beauséjour RHA
Stephen Wheatley Deputy Minister, Department of Supply and Services
Ashley Cummings Assistant Deputy Minister, Department of Supply and Services
David Johnstone Deputy Minister, Department of Transportation
Fred Blaney Project Manager, Fredericton to Moncton Highway Project, Trans-Canada Highway Project Co. Ltd
Denis Lachapelle Project Director, Trans-Canada Highway Project Co. Ltd.
Kevin Richard OMM/OMR Manager, Fredericton to Moncton Highway Project, Trans-Canada Highway Project Co. Ltd.
John Weatherhead Manager of Financial Services, Department of Transportation
Richard Burns General Counsel, Trans-Canada Highway Project Co. Ltd.
Ann Flewelling Department of Finance
David Hay President and CEO, NB Power Group
Jean Finn Assistant Deputy Minister, Department of Energy
Catherine Mosher Director of Operations, NBEFC

Richard Smith Vice President and Chief Financial Officer, ANBL
Jack Brown Assistant Deputy Minister, Dept of Family and Community Services
Barbara Burnett Director of Nursing Home Services, Dept of Family and Community Services
Don Ferguson Deputy Minister, Dept of Family and Community Services
John Rosengren Executive Director, Business Financial Support, Business NB
Deborah McQuade Executive Director, Financial Programs and Marketing, Business NB
Phil Vessey Audit Director, Office of the Auditor General
Shauna Woodside Accounting Services, Office of the Controller
Deidre Green Student Loan Portfolio Integrity and Assurance, Financial Services Branch, Dept of Post Secondary Education, Training and Labour
Lyne Paquet Acting Executive Director, Corporate Services, Dept of post Secondary Education, Training and Labour