PUBLIC ACCOUNTS

NORTHWEST TERRITORIES 2004 - 2005

Section IV Government Indicators

Northwest Territories

PUBLIC ACCOUNTS
OF THE
GOVERNMENT OF THE NORTHWEST TERRITORIES
FOR THE YEAR ENDED MARCH 31, 2005

SECTION IV

GOVERNMENT INDICATORS

(Unaudited)

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INTRODUCTION

The Public Accounts of a government report on the fiscal year's revenues and expenses and how they relate to the overall financial position of the Government. The Statement of Financial Position contains the assets, liabilities, total surplus or deficit and the net debt position or net financial resource position of a government. The information relating to assets or liabilities of the Government is specific to a point in time, whereas information relating to revenues and expenses encompasses the results of a fiscal year. It is important to note that the financial condition of a government is often quite different from the financial condition of the economy.

A research study conducted by the Canadian Institute of Chartered Accountants states:

The financial health of a government is it's financial health as measured by sustainability, vulnerability and flexibility, looked at in the context of the overall economic and financial environment. These terms are defined as follows:

- *Sustainability: the degree to which a government can maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy.*
- *Flexibility: the degree to which a government can increase its financial resources to respond to rising commitments, by either expanding its revenues, or increasing its debt burden.*
- *Vulnerability: the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence, both domestic and international.*

The information provided in the following pages is intended to assist readers of the Public Accounts in their assessment of the Government's financial health.

Gross Domestic Product

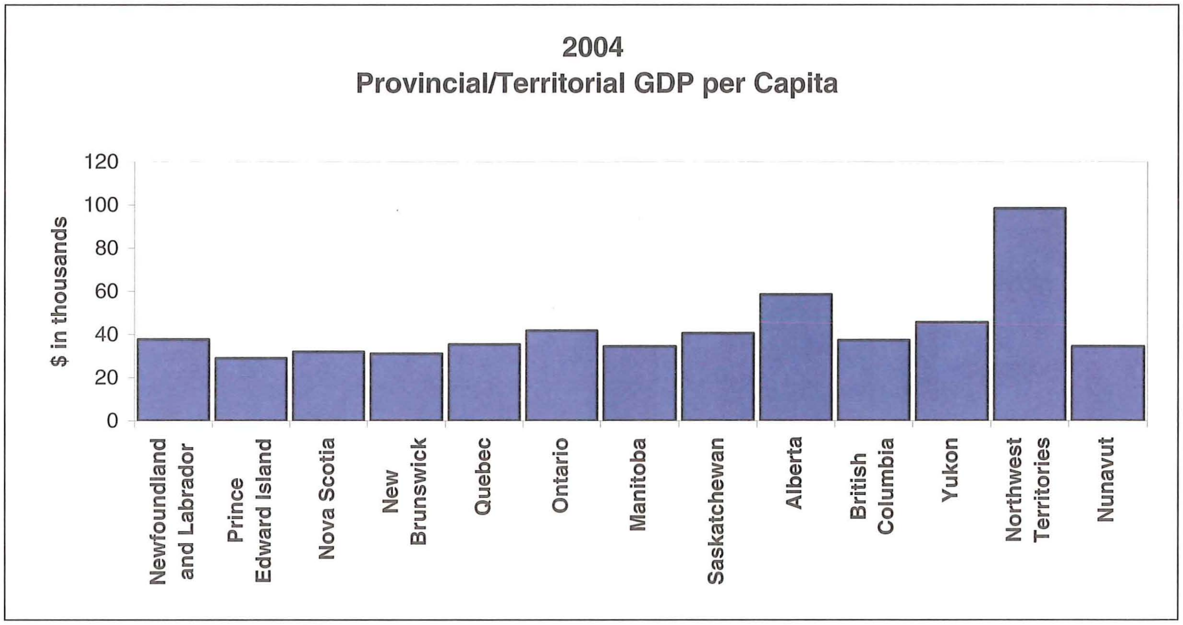
Gross Domestic Product (GDP) represents the total unduplicated value of goods and services produced within the geographical boundaries of a country, or province or territory, irrespective of whether the factors of production involved are resident or non-resident. GDP is typically measured in two ways: as total incomes earned in current production (income-based); and, as total final sales of current production (expenditure-based). Both methods yield the same estimate of GDP. Estimates of GDP are typically expressed at market prices, which includes the impact of taxes and subsidies in the estimate.

For the Northwest Territories (NWT), Statistics Canada estimates current dollar GDP at market prices at $4,208 million for 2004; this represents an increase of 16.0% over the 2003 estimate of $3,629 million. A final estimate of 2004 GDP for the NWT, and the other provinces and territories, is scheduled for release in October 2005; preliminary estimates of 2005 GDP will be released in April 2006.

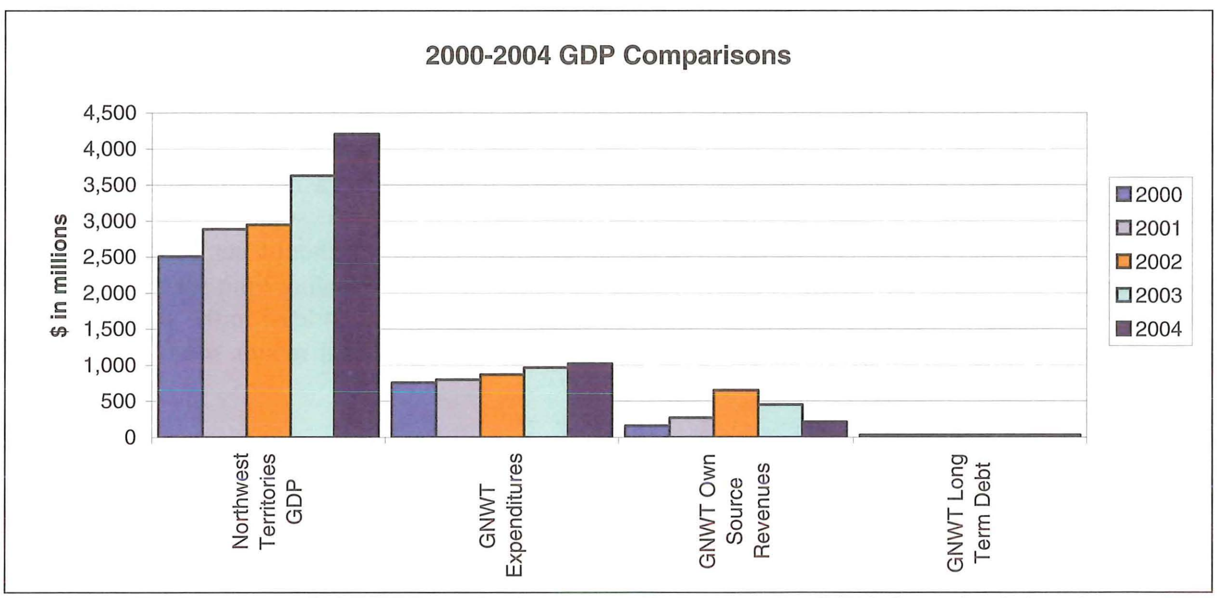
Gross Domestic Product at Market Prices, 2003 and 2004
Canada, Provinces and Territories
Current Dollars ($millions)

	2004	2003	Percent Change
Canada	1,293,289	1,218,772	6.1
Northwest Territories	4,208	3,629	16.0
Nunavut	1023	951	7.6
Yukon	1,424	1,327	7.3
British Columbia	156,481	145,500	7.5
Alberta	187,430	170,803	9.7
Saskatchewan	40,456	36,544	10.7
Manitoba	40,265	37,992	6.0
Ontario	517,614	494,501	4.7
Quebec	267,032	253,657	5.3
New Brunswick	23,369	22,452	4.1
Nova Scotia	30,036	28,912	3.9
Prince Edward Island	4,000	3,858	3.7
Newfoundland and Labrador	19,563	18,268	7.1

GROSS DOMESTIC PRODUCT (continued)

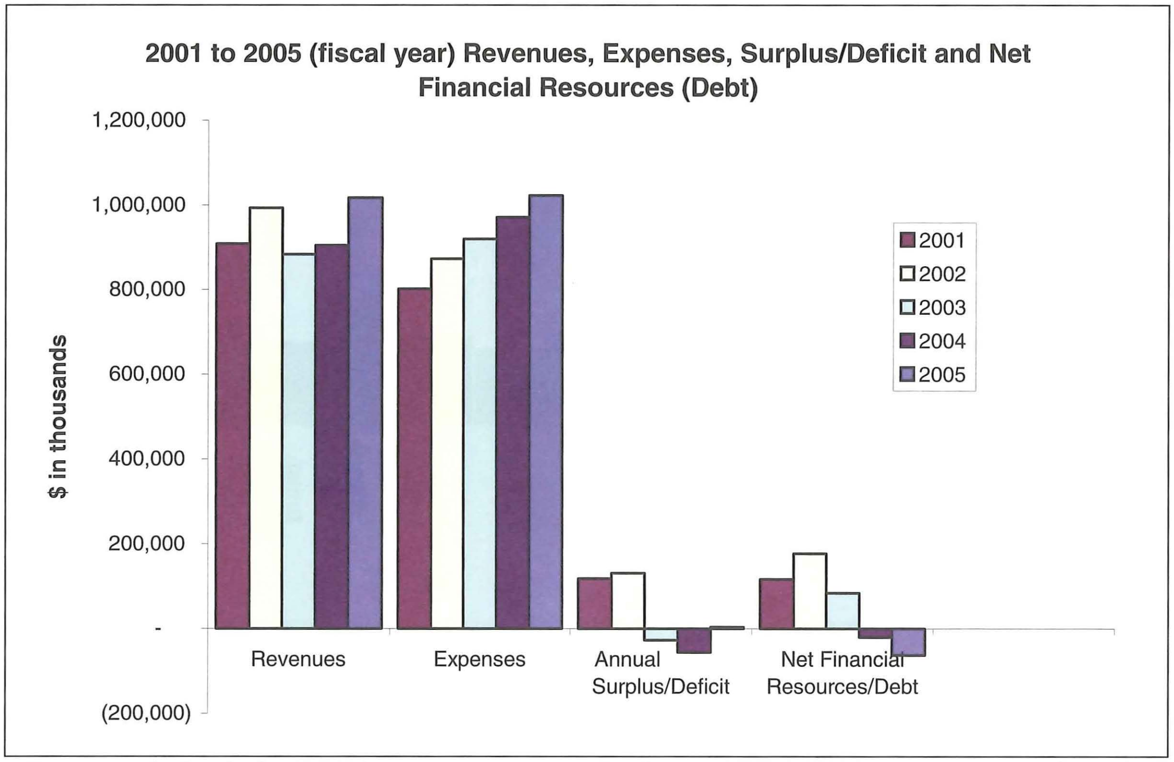


Based on population estimates of Statistics Canada as on July 1, 2004



*Northwest Territories GDP is based on a calendar year, while the balance of the information is based on amounts from March 31 fiscal year-ends.

REVENUE, EXPENSES, SURPLUS AND NET FINANCIAL RESOURCES



* Revenues depicted above exclude both recovery of prior years expenditures and revenue from the Northwest Territories Power Corporation.

The Government remains in a net debt position which translates into there being more outstanding liabilities than financial resources (assets) at the fiscal year end. This is graphically depicted in the following pages. Over the last four years the Government's net financial resources have been drawn down from a high of $176 million to a net debt position of $62 million, a decline of over $238 million. As discussed on page 6, some of the factors that contributed to this draw down are of a one-time nature, however should net debt continue to increase then a corresponding concern will be the $300 million borrowing limit set by Canada. In order that the Government's financial position remains sustainable, at least in the short-term, the Government must operate within these confines and yet ensure that it retains some flexibility to adapt and meet future needs.

REVENUE, EXPENSES, SURPLUS AND NET FINANCIAL RESOURCES (continued)

The table below illustrates, both as dollars and as a percentage, the increase in revenue and expenses over the last four fiscal years.

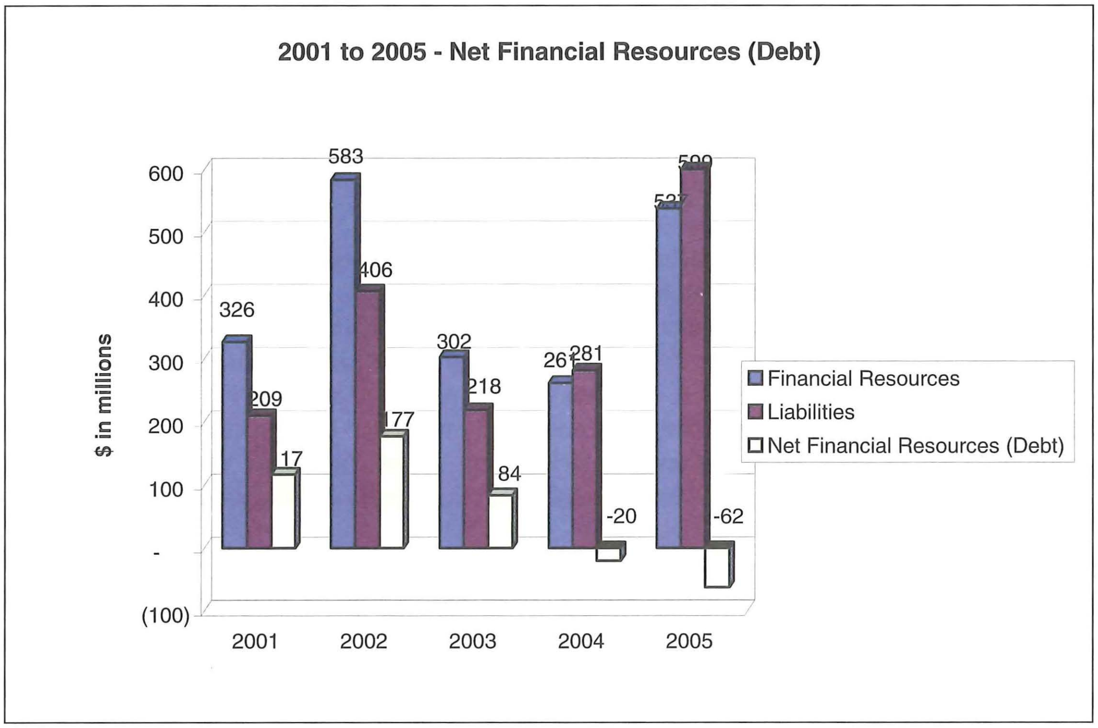
	2001 to 2002		**2002 to 2003**		**2003 to 2004**		**2004 to 2005**	
	$ Change (in thousands)	Percent Change	$ Change (in thousands)	Percent Change	$ Change (in thousands)	Percent Change	$ Change (in thousands)	Percent Change
Revenues	85,062	9.4%	(109,916)	(11%)	21,693	2.5%	115,894	12.8%
Expenses	70,800	8.8%	47,397	5.4%	50,870	5.5%	52,032	5.4%

While an increase (or decrease) maybe be significant, it is important to relate that change to the rate of change in other components. Examples of things to watch are: (1) expenses increasing at a faster rate than revenues, (2) an increase in net debt to maintain or improve services or (3) a fluctuation related to a one-time event or an event that may not re-occur in the future. Assessing the likelihood of any change in the level of revenues or expenses continuing into the future is an important factor to consider. This information can only be reviewed on a meaningful level when consideration is given to what is the driving factor such as inflation, new initiatives or other factors. These changes are important when assessing the long-term sustainability of the present level of services.

The trend over the last few years shows a steady increase in expenses of approximately 5% while revenues have fluctuated up and down with no apparent trend being discernable. One of the factors that contributes to revenues being more unpredictable than expenses in any given year is the large variation in corporate income tax collections starting in 2001-02. These variations were only partly offset by changes to the Grant from Canada. To further complicate the situation a portion of some variation in corporate income tax collections did not result in an adjustment to the Grant until the following fiscal year. In 2004-05 and 2005-06, the Grant became a fixed amount with a fixed percentage increase each year. Changes to overall government revenue will still remain difficult to predict even with a fixed Grant amount and a known annual increase as our own source of revenues (which comprise 21.8% of overall revenues) are subject to variation.

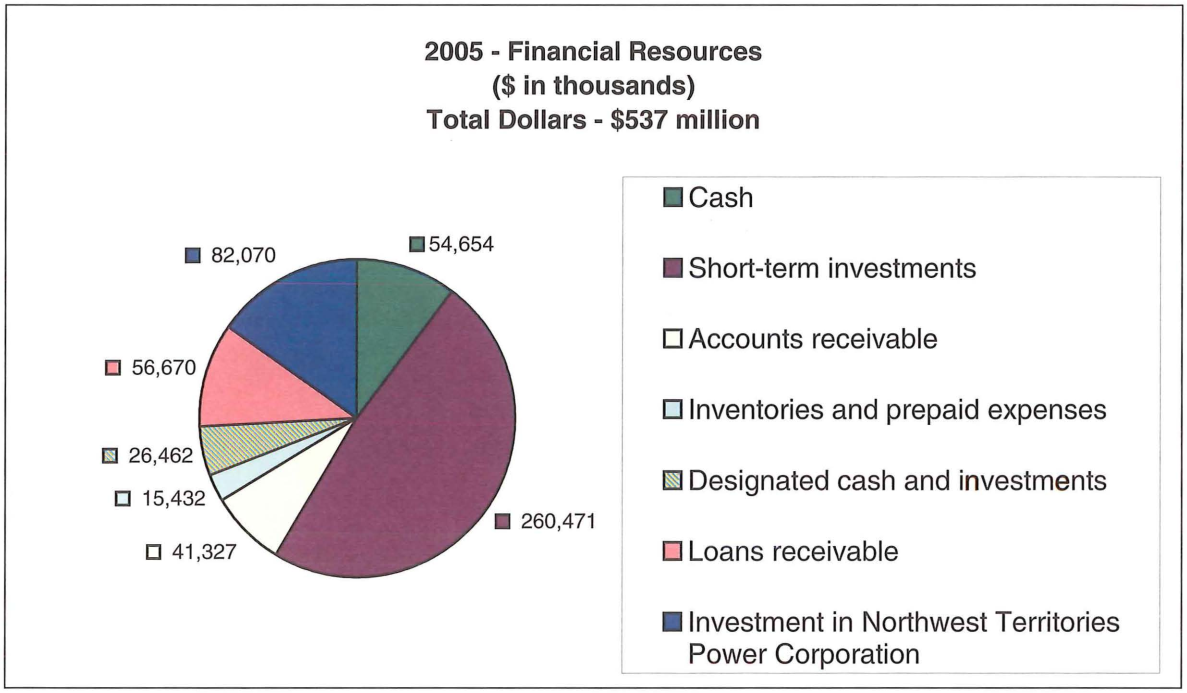
NET FINANCIAL RESOURCES (DEBT)

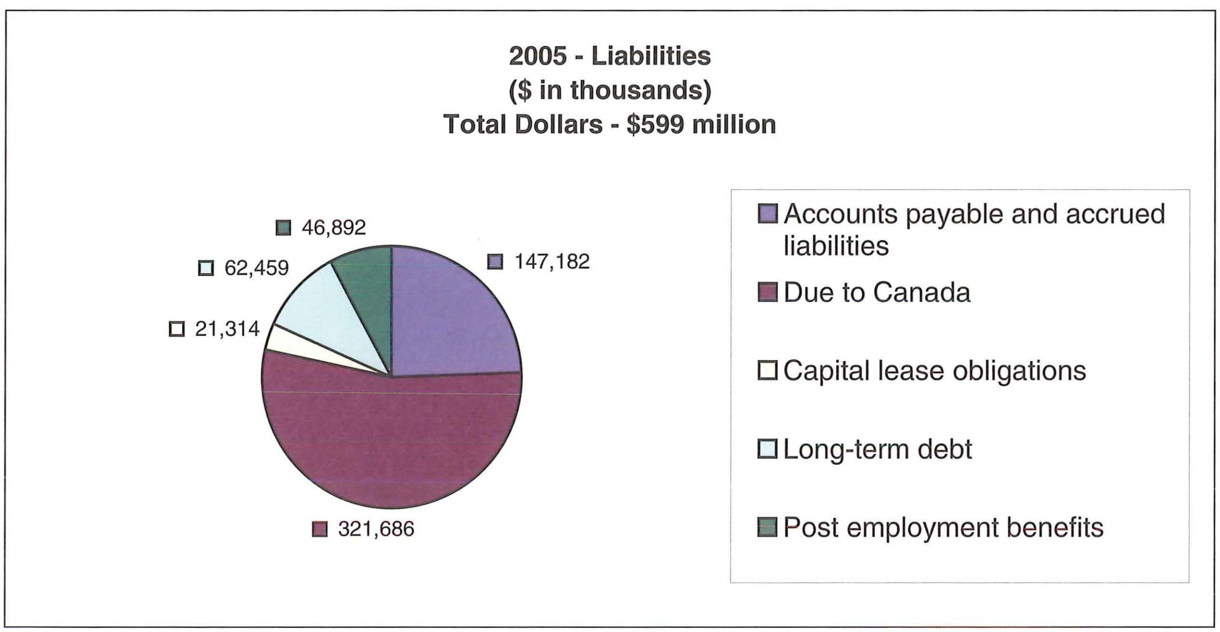
Net financial resources are the financial resources remaining after being reduced by all liabilities of the government; net debt results when there is an excess of liabilities over financial resources (as detailed on the next page). The graph below depicts the Government's net financial resource (debt) position at the end of each of the last five fiscal years.



Net financial resources (debt) is a good indicator of a government's ability to meet its existing financial obligations. A significant shift in the level of net financial resources versus liabilities has occurred over the last few years resulting in the Government moving to a net debt position. The fluctuation is exaggerated by unusual events that occurred in 2002 which increased our net resources beyond their average boundaries. The increase was the result of a significant increase to cash on hand due to a prepayment of the Grant by Canada and an overpayment of corporate income taxes which Canada collects for us. While our 2002 liabilities were also increased by the requirement to repay funds advanced on the Grant, the net effect was to temporarily inflate our net financial resources. In 2003 we saw the opposite effect, as these windfall items did not reoccur. Now in 2004 we continue to see the effect as Canada adjusts downward its calculation of the corporate taxes due to us to take into account the effect of the tax windfall. As mentioned previously, the Grant, at least for the short-term, is now a fixed amount and this may stabilize the ratio of resources to liabilities somewhat. Discussions with Canada with regards to revenue sharing may result in additional financial resources. However, in the interim, we may have to fund tangible capital assets with debt and this will impact our net financial position as discussed in the following pages. With so many variables in the calculation of our net financial position a prediction of an increase in our net debt cannot be made without in depth research. Net financial resources (debt) will always be affected by any dramatic changes in revenues or expenses. Long-term, net debt will increase if revenues do not keep pace or exceed the cost of government operations.

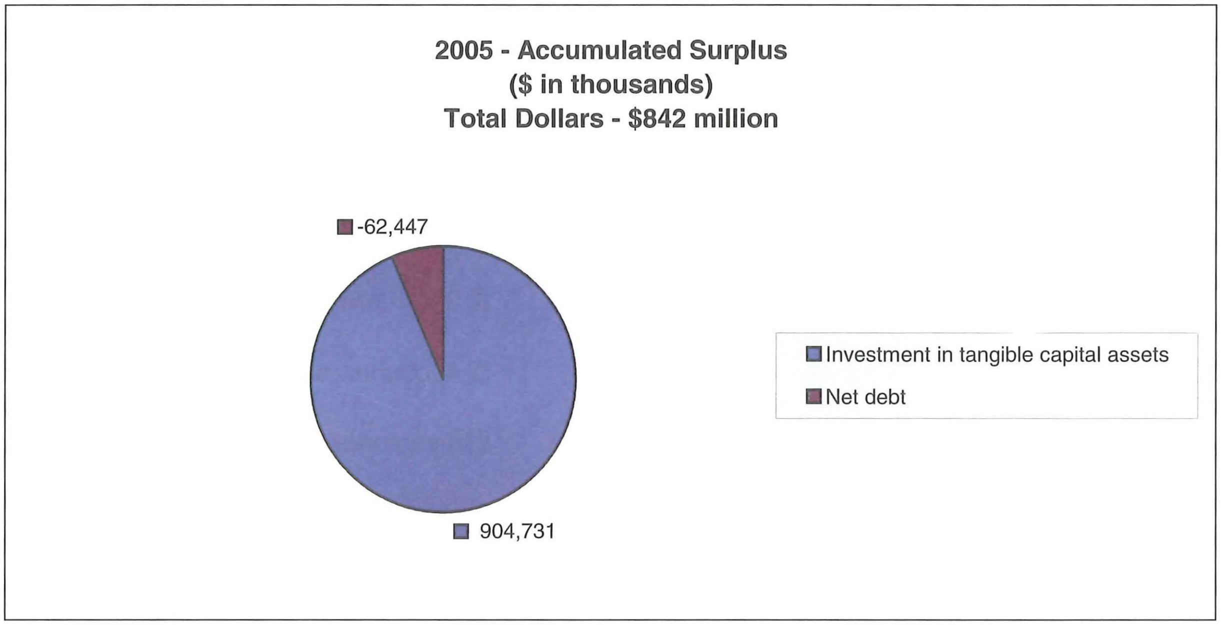
FINANCIAL POSITION





The above graphs illustrate the various compositions of the Government's financial resources and liabilities.

FINANCIAL POSITION (continued)

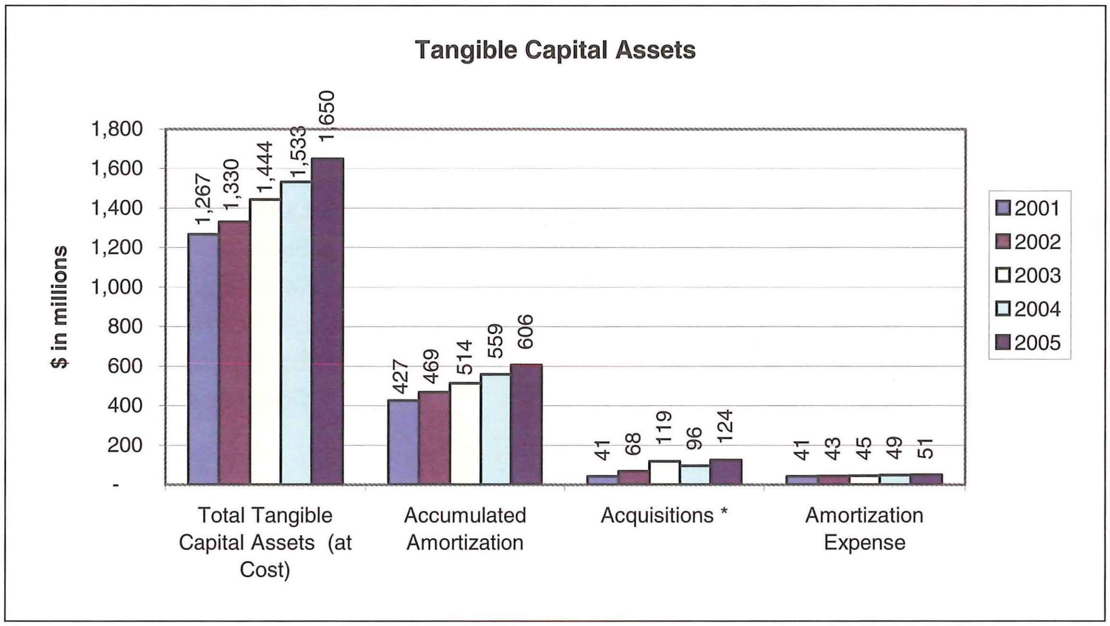


Up until the end of the 2004 fiscal year the Government was in a net financial resource position; this positive amount was added to the Government's investment in tangible capital assets to produce the accumulated surplus to date. However, now that the Government has moved to a net debt position this amount is removed from the Government's investment in tangible capital assets to show the remainder as accumulated surplus to date. The Government would only move to an accumulated deficit if the net debt position of the Government grew over time to the point where it exceeded the total investment in tangible capital assets. An important measure of the flexibility of a government is when there are surplus financial assets available to meet current and future obligations, as well as absorb any budgeted annual deficit. A net debt or net financial resource position is not a direct reflection of cash available but more an indication of sources where cash will or will not be available from to meet current and future obligations.

TANGIBLE CAPITAL ASSETS

Tangible capital assets include assets purchased directly by the Government and assets that were fully or partially contributed to the Government of the Northwest Territories by Canada or other parties.

The Government of the Northwest Territories records Tangible Capital Assets as non-financial assets on its Statement of Financial Position within the Public Accounts. Under this policy the existing assets are capitalized and then expensed as amortization in the financial statements of the Government based on their average useful life.

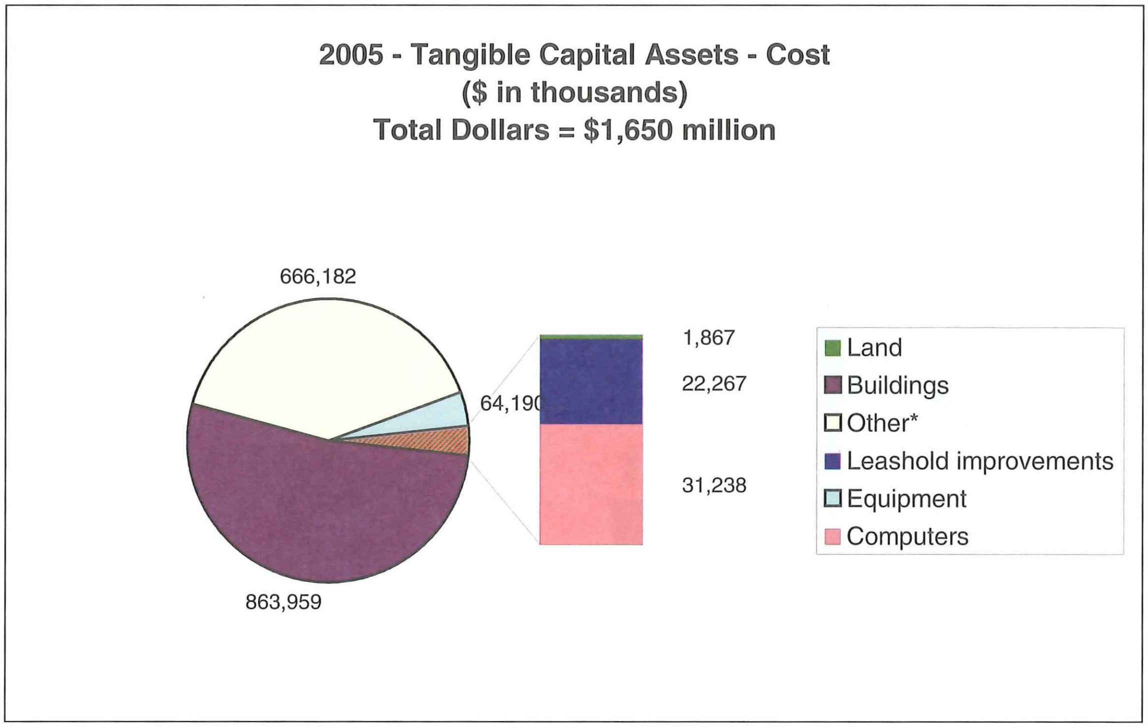


* Acquisitions do not include investments in assets that were not completed as at March 31 of any year. Such assets are recognized when completed and placed into service.

The Government must plan its capital expenditures to ensure that the existing assets are replaced and/or expanded in a timely manner and in conjunction with the Government's direction and priorities.

TANGIBLE CAPITAL ASSETS (continued)

The Government should continue to invest in the replacement of Tangible Capital Assets at a rate that, over time, approximates the rate at which assets are being consumed. Capital asset investment planning must address two essential points; (1) maintaining existing assets and (2) providing for growth.



*Includes roads, bridges, airstrips, aprons and water/sewer works

The Government of the Northwest Territories is currently investing in Tangible Capital Assets at a level that represents between 50% and 60% of the estimated investment needed for replacement and growth.

The Northwest Territories requires a significant investment in infrastructure. To ensure on-going fiscal sustainability, but still allow for necessary investments to address high priority infrastructure needs, the Government introduced the Fiscal Responsibility Policy effective April 1, 2005.

The Policy establishes an ongoing approach to finance the Government's infrastructure investments. The Policy requires that, at a minimum, 50 percent of its annual infrastructure investment will be financed by the cash generated from operations. A maximum of 50 percent of the annual infrastructure investment will be financed by debt. This will require the Government to plan for, budget and realize sufficient cash operating surpluses on an ongoing basis to finance 50 per cent of capital investments as well as make the debt servicing payments on the amounts borrowed.

TANGIBLE CAPITAL ASSETS (continued)

The Policy will require the Government to be accountable for its level of borrowing. To do this, performance criteria for debt management have been established to ensure the total debt of the Government does not exceed the capacity of the Government to repay the debt as it becomes due. These include:

i) Ratio: Government Debt to Revenue

This ratio is an indicator of the increase in debt in proportion to the increase in revenue, where *decreasing* ratios are a positive indicator that the rate of increase in revenue is greater than the rate of increase in debt.

From year to year, the ratio of total Government debt, excluding guaranteed debt, compared to non-consolidated revenue, in relation to provinces *shall be in the lowest 4*.

ii) Ratio: Debt per Capita

This ratio is a measure of the debt burden, on a per person basis, where a *decreasing* ratio is a positive indicator of a decreasing debt burden.

From year to year, the total debt per capita ratio, compared to provinces *shall be in the lowest 5*.

iii) Debt Servicing Costs (interest), as a % of Revenue

This ratio is a measure of the extent that Government revenues are being applied to debt charges, rather than to programs and services, or tax reduction.

From year to year, debt servicing costs on Government debt, excluding amounts paid by Public Agencies, as a % of non-consolidated revenue, compared to other provinces and territories *shall be in the lowest 4*.

iv) Debt Servicing Payments, as a % of Revenue

This is a measure of the extent that Government revenues are being applied to debt charges and debt repayment, rather than on programs and services or to reducing taxes.

From year to year, payments on Government debt, excluding Public Agency debt service payments, as a % of non-consolidated revenue *shall not exceed 5% of revenue*.

TANGIBLE CAPITAL ASSETS (continued)

v) Debt Servicing Payments as a % of 3-year moving GDP average

This ratio is a measure of debt growth in relation to economic growth, where ideally economic growth exceeds the growth rate of public debt. A *decreasing* ratio reflects a consistent improvement in financial position.

Given the volatility of GDP in the Northwest Territories, a 3-year moving average GDP shall be used.

From year to year, debt-servicing payments, excluding Public Agency debt, as a % of the 3-year moving GDP average, compared to debt servicing payments of provinces *shall be in the lowest 4*.

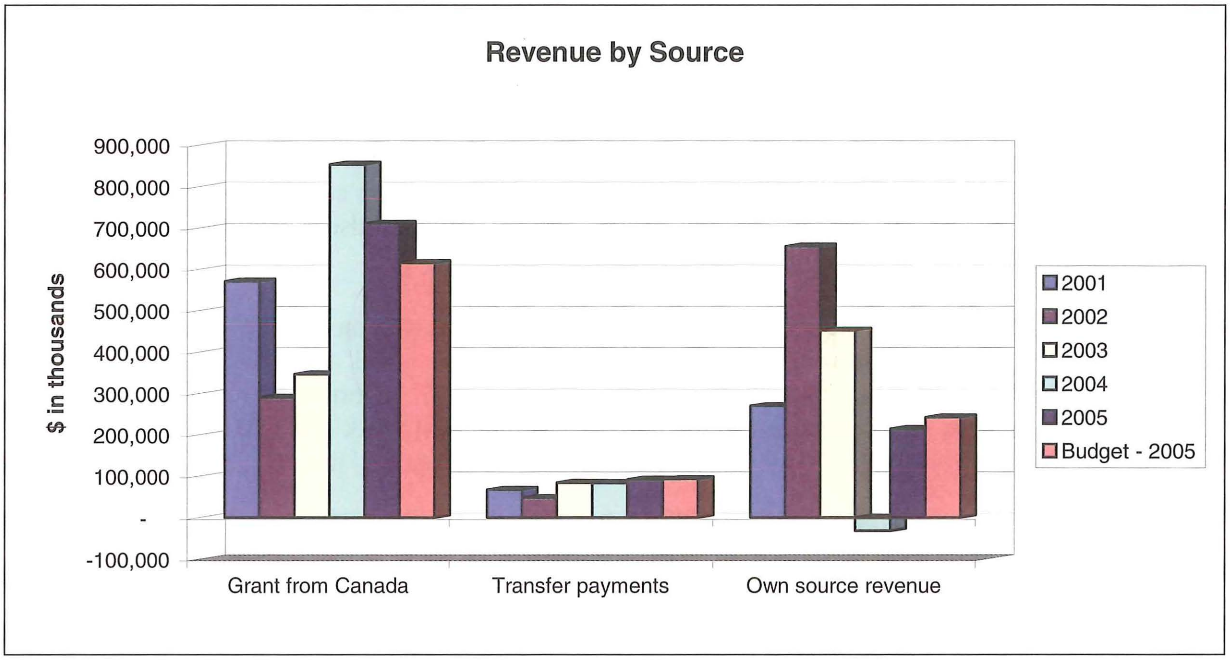
vi) Net Debt per Capita

Net debt is the excess of liabilities over financial assets.

From year to year, non-consolidated net debt per capita, compared to provinces *shall be in the lowest 5*.

The GNWT policy on borrowing and performance measurement criteria, for management of debt, will be reviewed and updated annually. Annual reports shall be tabled in the Legislative Assembly.

REVENUE BY SOURCE



In a normal year the Government of the Northwest Territories receives between 65 to 75 percent of its revenues from the Formula Financing Grant from Canada. Major own-source revenues, such as corporate and personal income tax, tobacco tax, fuel taxes, and payroll tax are approximately 25 to 30% of total revenues. Other transfers are approximately 7% of total revenues. Although the Northwest Territories has a vast reserve of non-renewable resources, it does not currently share in the revenue produced by those resources (royalties, etc). The intended result of tri-party negotiations between Canada, the Government of Northwest Territories and Northwest Territories Aboriginal Governments, is the sharing of those resource revenues.

Prior to 2004-05 the Grant from Canada was based on a formula designed to cover the difference between expenditure needs and the Government of the Northwest Territories' revenue-raising ability. Therefore, changes to the Government of Northwest Territories' own source revenue levels would change the Grant in the opposite direction. Since the revenue-raising ability measures what the Government could raise at eighty-five percent of national average tax rates in the base year and included an Economic Development Incentive, changes in own source revenue levels would not change the Grant by a corresponding amount.

The Territorial Formula Financing arrangement was designed to provide an incentive for the Government of the Northwest Territories to raise revenues. Therefore, an increase in tax rates that provides increased tax revenues would not affect the Grant. For example, if fuel taxes were raised one cent per litre from the base year rate, the fuel tax revenue for purposes of calculating the Grant would still be at the lower rate. Therefore, the Government of the Northwest Territories could keep the additional revenue generated by an increase to its tax rates, at least until the Territorial Financing Formula was next rebased.

REVENUE BY SOURCE (continued)

The Territorial Financing Formula expenditure base amount was escalated each year by the growth in provincial/local government spending and the ratio of population growth in NWT to the growth of the Canadian population. The data used to calculate these growth rates was not finalized until three years later for provincial/local government spending and five years later for population data. Therefore, adjustments to the Grant for a fiscal year could occur up to five years later. Since the escalation is cumulative, adjustments for prior years could have significant effects on total revenues. Corporate and personal income taxes estimates also take three years to finalize and required further adjustments to the Grant.

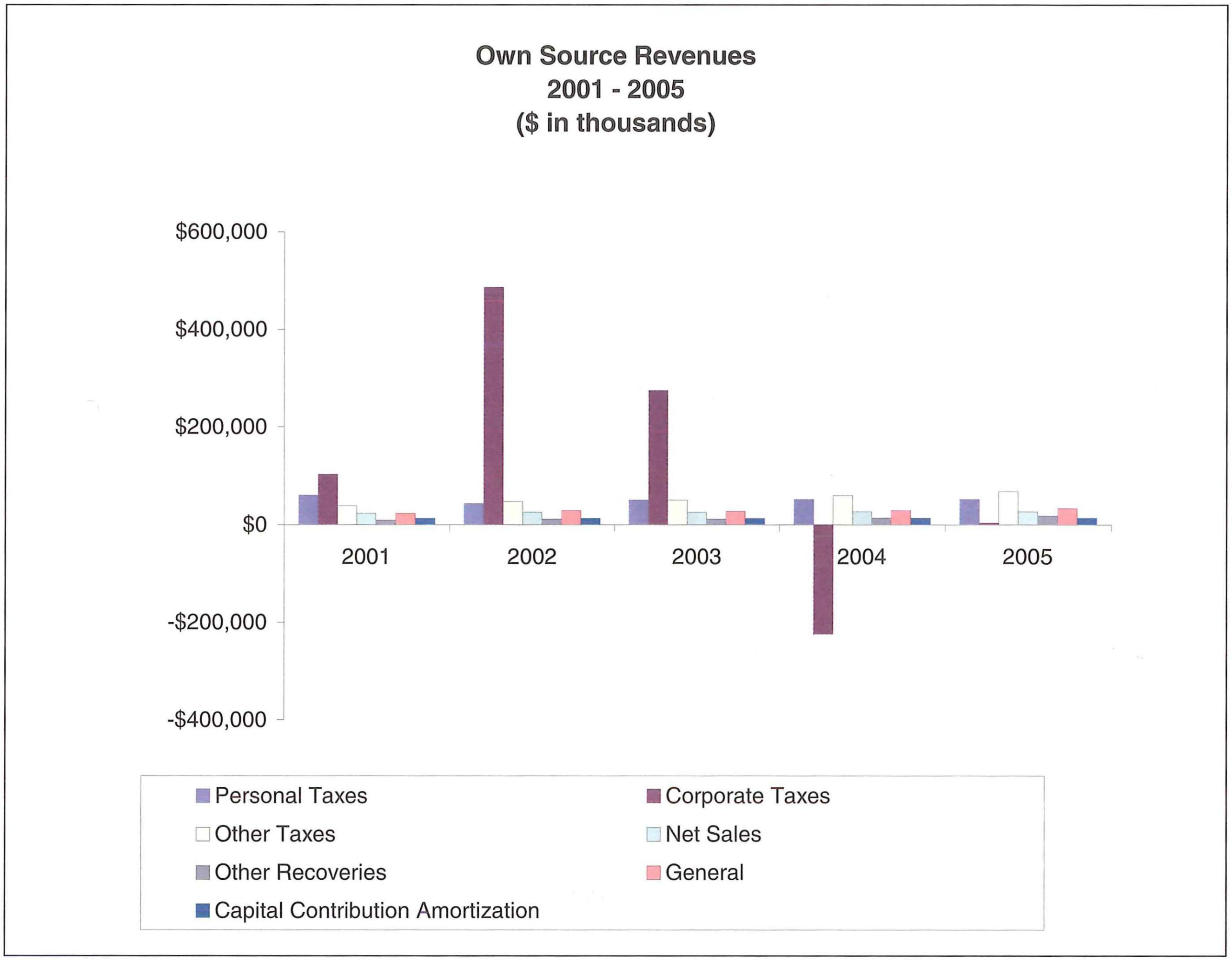
Territorial Formula Financing has been fixed in federal legislation for the years 2004-05 and 2005-06 and is currently being reviewed by a federal panel that is expected to make recommendations in the fall of 2005. Until the federal government reviews the panel's recommendations and announces how formula financing will work after 2005-06, the effect of changes to the Government's own source revenues on the Grant will not be known.

As indicated in the graph on the following page, Corporate Income Tax is a negative revenue for the 2003-04 fiscal year. This negative amount is the result of an overpayment of 2002 Corporate Income Tax to us by the federal government. The federal government bases estimates of Corporate Income Tax on the latest actual prior year tax revenue information available (for example, 2002 estimates were based on 2000 actual collections). The 2002 estimate of NWT Corporate Income Tax was based on a large one-time payment in 2000, and the resulting overpayment in 2002 more than offsets the estimated revenue from the 2003 Corporate Income Tax.

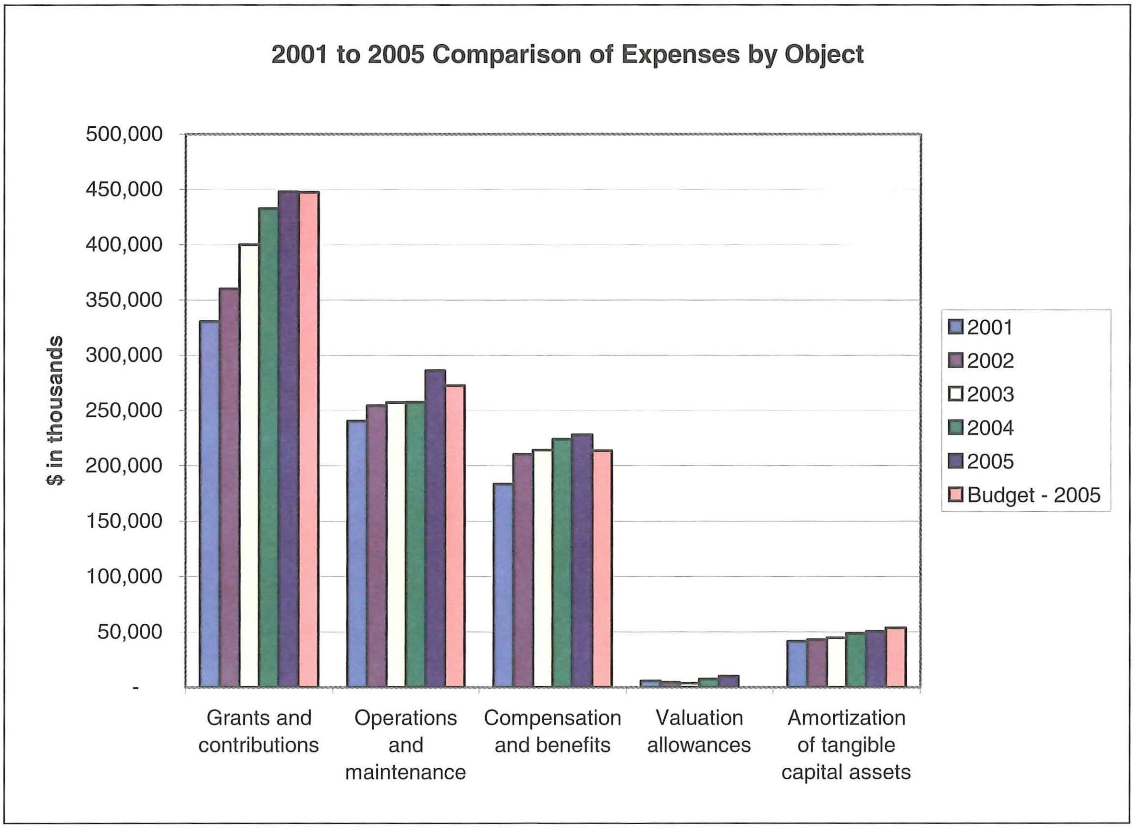
This overpayment of Corporate Income Tax is also the main reason for the increase in the 2003-04 Formula Financing Grant entitlement in comparison with the 2002-03 amount. The downward revision of Corporate Income Tax revenues caused an increase in the 2002-03 Grant. This increase is recorded in 2003-04 as an adjustment to the Grant revenue.

For 2004-05, the graph on the following page, shows revenues that relate more to those of the 2000-01 year when the Corporate tax calculation reflected a more average year.

REVENUE BY SOURCE (continued)



EXPENSES BY OBJECT

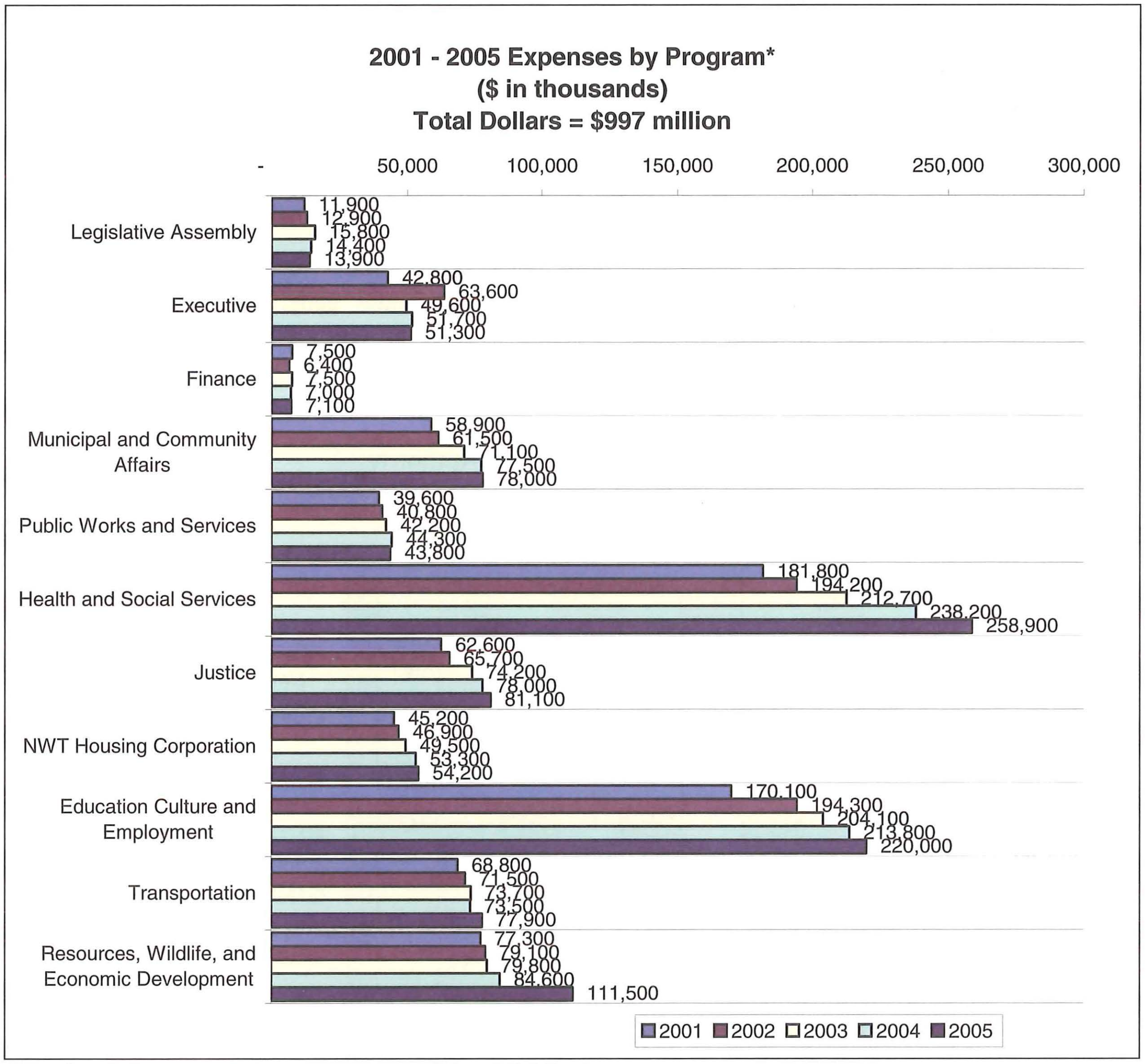


The expenses of the Government are such that a large percentage of its costs are fixed. Grants and contributions to third parties such as boards and agencies also have many components that are fixed and as the major (or sole) provider of funds, the Government cannot vary the funding without affecting the level of output by these boards and agencies. Approximately 43.8% (2004 – 44.6%) of the Government's total expenditures for 2004-05 were for Grants and Contributions. Many of our social and educational programs are funded by these contributions.

Additional types of fixed costs are long-term, such as lease and other commitments which are disclosed in note 17 to the Consolidated Public Accounts.

The Government is also vulnerable to inflation as it is an important factor when negotiating compensation and benefits. Not only are the direct wages of the Government (approximately 22.3 % (2004 – 23%) of the government's total expenditures) vulnerable to this but wages also make up a significant portion of the grants and contributions given to third parties.

EXPENSES BY PROGRAM



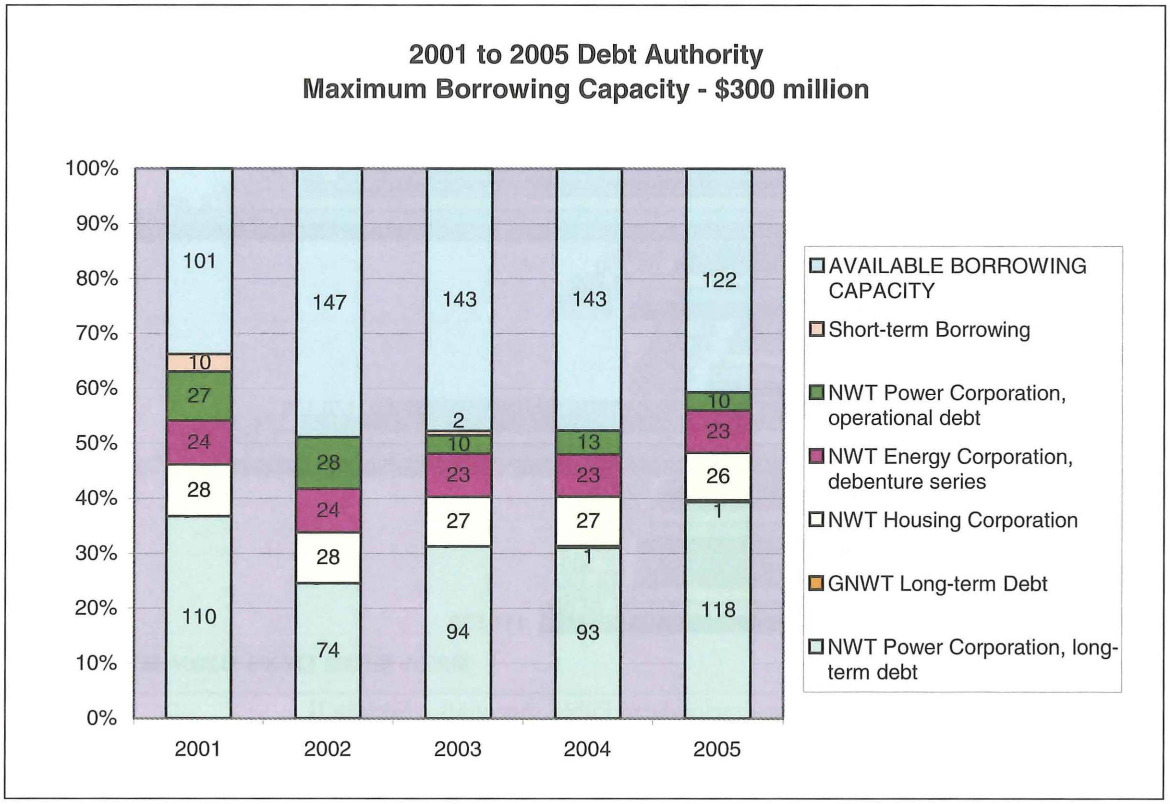
*based on information from the Non-consolidated Public Accounts – Section II

In the 2005 fiscal year, the Government spent 62% (2004 – 62%) of its total budget on social programs (education, health, support to community governments, justice and housing). Most of the remaining budget is allocated to infrastructure, natural resources and economic development. Any additional resources to improve a service often have to be made at the expense of other important needs. Balancing a budget entails not only controlling expenses but also finding the most effective and efficient mix of programs.

LONG-TERM DEBT BORROWING CAPACITY

Canada, pursuant to subsection 20(2) of the *Northwest Territories Act,* has approved Government borrowing up to $300 million. This includes debt of the various Government entities' that are consolidated. The consolidation includes the Northwest Territories Housing Corporation and the Northwest Territories Power Corporation and includes the Northwest Territories Opportunities Fund, however the latter is excluded for purposes of the calculation of government borrowing. If future monetary requirements should require borrowing in excess of the approved limit of $300 million a review of the Government's overall borrowing capacity with Canada would be required.

The borrowings of the Northwest Territories Power Corporation (NTPC) and the Northwest Territories Energy Corporation are serviced through revenues generated by the NTPC and Northwest Territories Energy Corporation and, as such, do not require the Government fund the related interest expense or principal repayment.

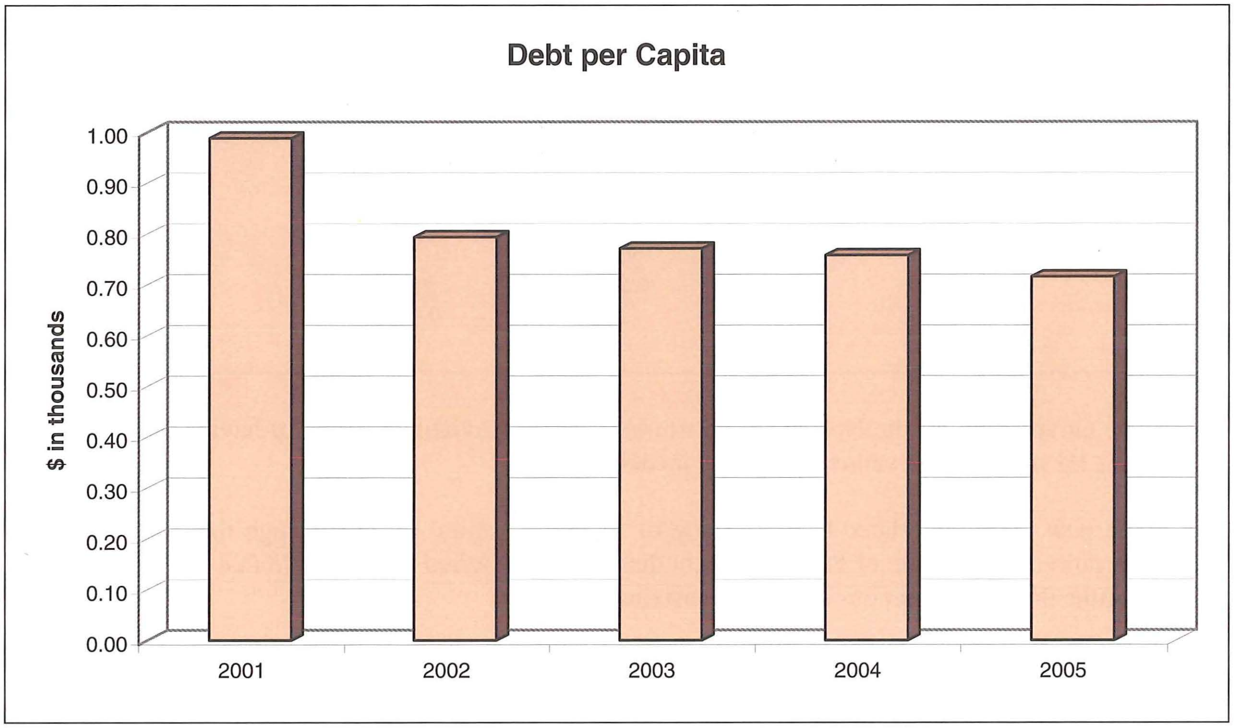


The Government's borrowing has increased in the last year, relative to the past three years. The increase is due to operational requirements such as the requirement to refund a significant amount of corporate income tax as disclosed in the Public Accounts (note 3) and the requirement to record a $24M liability related to the Giant mine environmental clean-up.

The debt level will likely continue to increase given that the Government has had to implement a borrowing strategy to allow it to address current infrastructure needs while a revenue sharing agreement has not yet been reached. The Government continues to work towards renegotiating the debt cap of $300M and in anticipation of implementing the new borrowing strategy has obtained a credit rating of Aa3 for the Government from Moody's Investors Service.

DEBT PER CAPITA

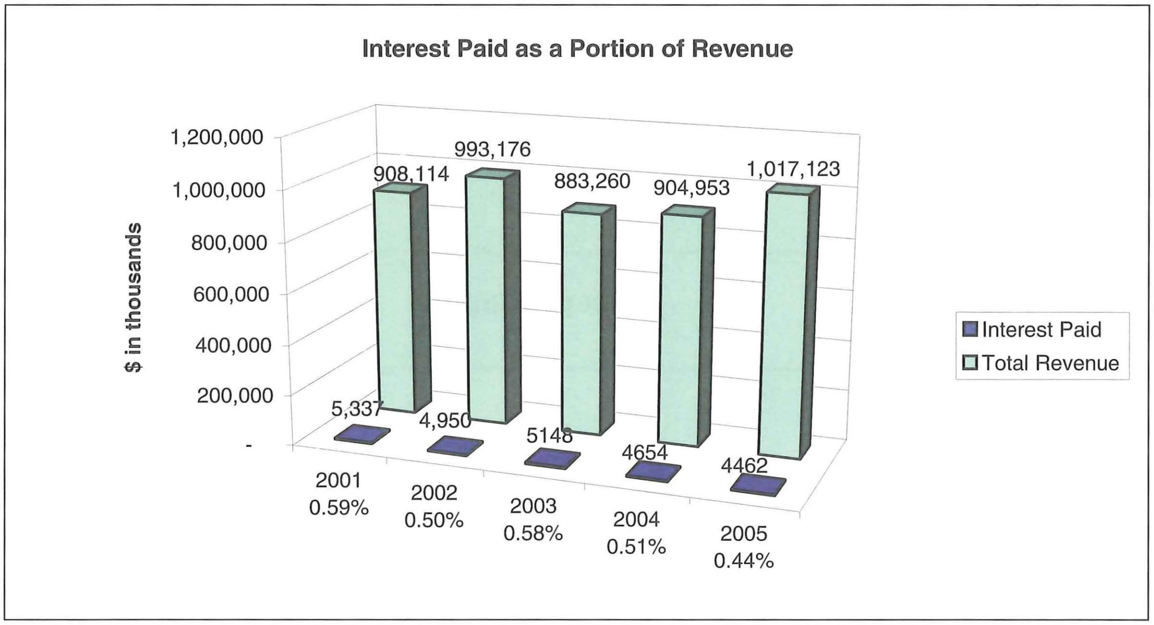
The following chart depicts the debt per capita with respect to the entire debt load that the Government of the Northwest Territories is directly responsible for. This debt is defined as short and long-term borrowing and excludes the borrowings of the Northwest Territories Opportunity Fund. At March 31, 2005 the long-term debt was $31 million, with no short-term borrowings.



Based on Statistics Canada population as at July 1, 2004

The trend above can best be analyzed by considering the debt levels disclosed on the previous page and taking into consideration that the Northwest Territories population grows every year.

INTEREST



The Government of the Northwest Territories is in the enviable position of having to expend less than 1% of its total revenues to service its debt load.

The new initiative related to purchasing of Tangible Capital Assets through the use of debt has the ratio above as one of the parameters that will be reported on to ensure that any new debt we assume does not affect our long-term sustainability.

CONCLUSION

As described in the Introduction, the CICA has suggested that a government's financial health should be measured in terms of sustainability, flexibility and vulnerability. The preceding measures have attempted to illustrate how the Government of the Northwest Territories' fiscal health measures up from this standpoint. This suggests the following conclusions:

Sustainability – at the end of the 2004-05 fiscal year the Government of the Northwest Territories had increased its liabilities in excess of financial assets by $42 million. This net debt position means approximately 4.1% of the year's expenses, or 2 weeks of operations were financed by incurring debt beyond our financial assets. The Government's long-term debt was $31 million or 2.9% of the Government revenues for the year and less than 1% of the Northwest Territories Gross Domestic Product. These measures suggest that the Government of the Northwest Territories may not be able to maintain current programs without increasing the debt burden on the economy to some degree but that an increased debt load is sustainable.

Flexibility – this pertains to the Government's ability to increase its financial resources. The Government of the Northwest Territories own source revenues were negative in the 2003-04 fiscal year, as the result of a corporate income tax claw back by the federal government. In order to make a meaningful comparison prior years own source revenues must be looked at excluding any income tax revenue. When own source revenues are looked in this manner the increase in revenues in the current year is 11%. The balance of revenues came largely through the Grant (Formula Financing Agreement with the federal government). The Government does not have access to resource royalty revenues as the federal government continues to control all Northwest Territories subsurface resources. The Government of the Northwest Territories has a federally imposed limit on its borrowing of $300 million, and although it is currently under its limit, $300 million represents only 29% of 2004-05 expenses or 15 weeks of operations. The Government of the Northwest Territories' flexibility is severely constrained by these factors.

Vulnerability – this is a measure of how dependent a government is on sources of funding outside its control or influence. To assess the Government of the Northwest Territories vulnerability it is not necessary to look further than the Government's limited own source revenues and the volatility related to corporate income tax. The Grant from Canada has been renegotiated for both the current year and 2005-06 at a fixed amount however, beyond that, the level of funding is not known with any certainty at this time. The agreement is normally renewed every five years at which time it is subject to negotiated or federally imposed changes.

In summary, the Government of the Northwest Territories is financially stable at this point in time but it has limited flexibility to raise new revenues or incur debt and it is very vulnerable to federal changes to its future revenues.

ADDITIONAL SOURCES OF INFORMATION

The Government of the Northwest Territories produces several other documents and web sites that may be referenced for additional information.

Sources include:

- Government of the Northwest Territories Web Site at www.gov.nt.ca
- Government of the Northwest Territories Public Accounts
  - Section I – Consolidated Financial Statements
  - Section II – Non-Consolidated Financial Statements
  - Section III – Supplementary Financial Statements
- Government of the Northwest Territories Main Estimates
- Business Plans
- Geographic Tracking Report
- Results Report