Financial Summary

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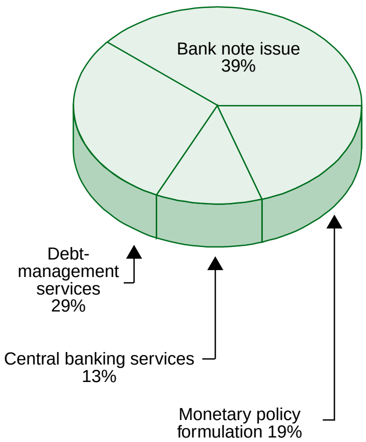
Operating expenses by function



As described in this report, 1996 was a year of change at the Bank of Canada, driven mainly by the activity review that was initiated in 1995. Overall, expenses were down in 1996, despite significant one-time expenses and higher costs associated with a modification in the way the Bank accounts for staff benefits. Of particular note is the steady decline over the past three years in the proportion of resources spent on bank note issue (39 per cent in 1996 compared with 48 per cent in 1994).

Operating expenses

Total operating expenses for 1996 were about 3 per cent lower than the 1995 level. Excluding the one-time expenses, operating costs fell by nearly $9 million, or by 5 per cent. This is about $30 million below the level recorded in 1994, which is the base year identified in the activity review for measuring progress on achieving efficiency gains. It is expected that once all the planned changes from the activity review are completed in 1998, the direct annual savings to the Bank will be in the order of $40 million. However, some of these savings will be offset by new initiatives such as the regional offices and developments in the retail debt area.

Salaries and other staff costs were lower overall in 1996. The reduction is associated with the partial-year effect of early retirements and voluntary departures under the Bank's Workforce Adjustment Program. Nearly 370 employees left the Bank voluntarily during 1996. The lower staff requirement was made possible by lower volumes and by the many changes in business procedures and service levels that resulted from the activity review.

Although staff benefits have not changed, there was an increase in other staff expenses in 1996 because of a shift in the timing of expense recognition for staff benefits. The costs of all staff benefits are now either accrued or paid as they are earned. The change brings the Bank's accounting practices fully in line with generally accepted accounting principles. In all, the changes in accounting practices added close to $4 million to other staff expenses in 1996.

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Operating expenses by function
Millions of dollars

	1994	1995	1996
Monetary policy	33.8	33.0	35.0
Central banking services	19.3	20.8	22.8
Bank notes	101.4	80.0	69.6
Debt-management services	54.7	54.0	51.6
Subtotal	209.2	187.8	179.0
Other (non-recurring) expenses		33.0	34.7
Total	209.2	220.8	213.7

The decrease in 1996 operating expenses is explained mainly by reduced expenses in the bank note function, continuing the marked downward trend since 1994. This reflects both lower volumes (driven primarily by the decision to stop issuing the $2 note) and the closure or consolidation of certain operations.

In 1996 expenses also fell in the debt-management function, specifically those expenses associated with treasury bill and marketable bond services. The cost of these services has been falling steadily over the past five years, largely because of the computerized clearing and settling of marketable bond and treasury bill transactions.

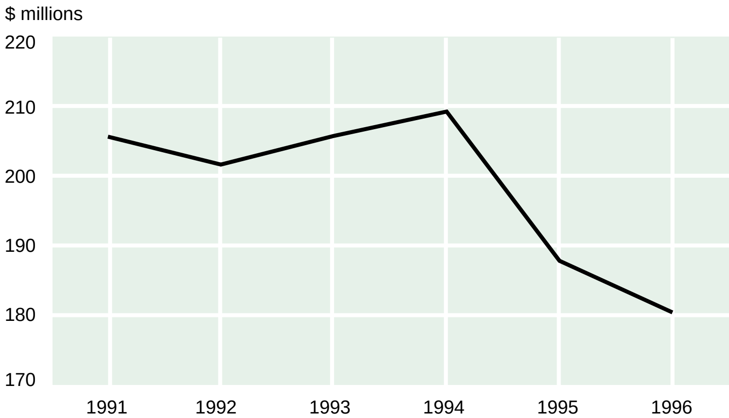
In the remaining two functions, monetary policy and central banking services, continuing efforts to streamline and rationalize activities were more than offset in 1996 by investment in systems and tools.

“Other expenses” of $34.7 million represent several one-time items. The largest expense ($22.3 million) relates to the cost of settling legal challenges to the Bank of Canada’s security interests in the liquidation of the Canadian Commercial Bank. After eight years of court challenges, these settlements with three major unsecured creditors should expedite the final liquidation of the institution. Also included in other expenses is $5 million that was expensed for the Bank’s Workforce Adjustment Program in 1996 to cover the estimated cost of termination benefits associated with the elimination of about 100 positions over the next two years. These positions were identified as a result of activity reviews conducted during 1996. The reductions are in addition to the approximately 500 positions that were identified and provided for in 1995.

Finally, other expenses include a one-time provision of $3 million to recognize a liability for unused vacation entitlements earned prior to 1996, and a $4.4 million loss on net book value resulting from the sale of the St. Andrew's Tower in Ottawa. The building was sold because the Bank's space requirements are falling as changes resulting from the activity review are being implemented.

Net operating expenses

Excluding *Other expenses*



In 1996, for the fifth consecutive year, salary ranges at the Bank remained unchanged. For 1997, with the end of the federal public sector salary freeze, the Bank's Board of Directors decided that there would be no general increase in salary ranges. Rather, increases averaging one per cent of total payroll have been given to lower-paid employees and to critical skill areas (information technology and economist groups) where market pressures are strong and the Bank's compensation levels are below those in the public and private sectors. These measures reflect the Bank's desire to ensure that it has a competitive, equitable salary structure that is also consistent with its responsibilities as a public sector institution. In addition, in line with the federal public sector, performance-based progression within pay ranges was restored beginning 1 January 1997.

Revenue

Total revenue was $1.6 billion in 1996, down from $2 billion in 1995. The Bank's principal source of revenue is interest earned on its holdings of federal government securities. Revenue declined mainly because falling interest rates resulted in a lower average return on these assets. With net expenses of $0.2 billion, net revenue paid to the Government of Canada in 1996 was $1.4 billion, down $0.4 billion from the previous year.

However, net revenue is not a good indicator of the Bank's management performance. The Bank deals in financial markets to achieve policy goals, not to maximize its revenues, and revenues are highly dependent on the general level of interest rates. For these reasons, the level of operating expenses is a better indicator of the Bank's stewardship of public resources.