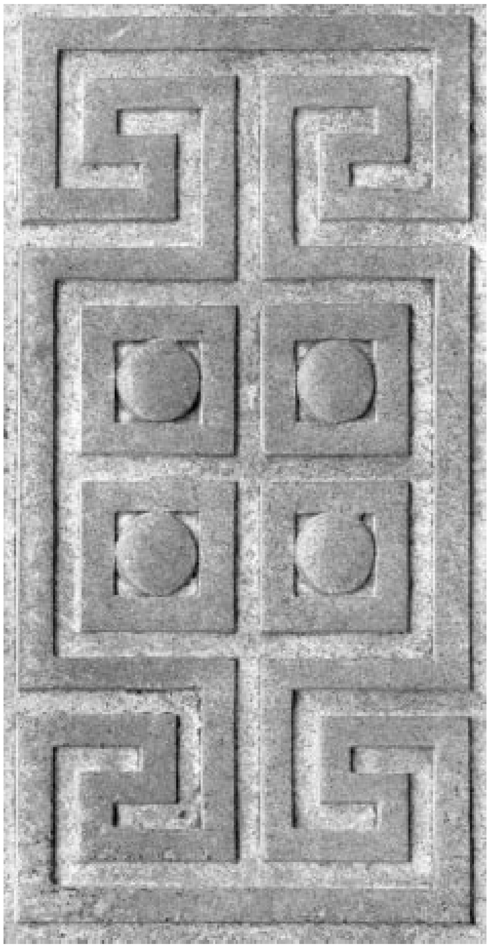

# FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 1997

# Bank of Canada
# Financial reporting responsibility

The accompanying financial statements of the Bank of Canada have been prepared by management in accordance with accounting principles generally accepted in Canada and have been consistently applied. The integrity and objectivity of the data in these financial statements are management's responsibility. Management is responsible for ensuring that all information in the annual report is consistent with the financial statements.

In support of its responsibility, management maintains financial and management control systems and practices to provide reasonable assurance that the financial information is reliable, that the assets are safeguarded and the operations are carried out effectively. The Bank has an internal audit department whose functions include reviewing internal controls and their application, on an ongoing basis.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control and exercises this responsibility through the Audit Committee of the Board. The Audit Committee reviews the Bank's annual financial statements and recommends their approval by the Board of Directors. The Audit Committee meets with management, the internal auditors, and the Bank's external auditors appointed by order-in-council.

These financial statements have been audited by the Bank's external auditors, Coopers & Lybrand and Caron Bélanger Ernst & Young and their report is presented herein.

G.G. Thiessen, Governor

L.T. Requard, Corporate Secretary

Ottawa, Canada
12 February 1998

AUDITORS OF THE BANK OF CANADA
VÉRIFICATEURS DE LA BANQUE DU CANADA

C. P. 813, SUCCURSALE B — P.O. BOX 813, STATION B

OTTAWA, CANADA
K1P 5P9

CARON BÉLANGER ERNST & YOUNG — COOPERS & LYBRAND

## AUDITORS' REPORT

To the Minister of Finance, registered shareholder of the Bank of Canada

We have audited the balance sheet of the Bank of Canada as at 31 December 1997 and the statement of revenue and expense for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 1997 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

Caron Bélanger Ernst & Young
Chartered Accountants

Coopers & Lybrand
Chartered Accountants

Ottawa, Canada
23 January 1998

# Bank of Canada
# Statement of revenue and expense

## Year ended 31 December 1997

| | 1997 | 1996 |
|---|---|---|
| | **Millions of dollars** | |
| **REVENUE** | | |
| **Revenue from investments, net of interest paid on deposits of $3.8 million ($9.8 million in 1996)** | **1,578.6** | 1,648.8 |
| **EXPENSE by function** (notes 1 and 3) | | |
| Monetary policy | **37.4** | 35.0 |
| Central banking services | **25.5** | 22.8 |
| Currency | **65.7** | 69.6 |
| Debt-management services | | |
| Market debt services | **8.4** | 9.9 |
| Retail debt services | **47.7** | 41.7 |
| | **184.7** | 179.0 |
| Less retail debt recoveries | **(28.9)** | - |
| | **155.8** | 179.0 |
| Other expenses (revenue) | **(11.6)** | 34.7 |
| | **144.2** | 213.7 |
| **NET REVENUE PAID TO RECEIVER GENERAL FOR CANADA** | **1,434.4** | 1,435.1 |

**(See accompanying notes to the financial statements.)**

# Bank of Canada
# Balance sheet

## As at 31 December 1997

| ASSETS | 1997 | 1996 |
|---|---|---|
| | Millions of dollars | |
| **Deposits in foreign currencies** | | |
| U.S. dollars | **383.1** | 235.0 |
| Other currencies | **3.2** | 4.0 |
| | **386.3** | 239.0 |
| **Advances to members of the Canadian Payments Association** | **363.3** | 553.8 |
| **Investments** (note 7) | | |
| Treasury bills of Canada | **14,065.0** | 17,416.5 |
| Other securities issued or guaranteed by Canada maturing within three years | **4,165.7** | 2,328.3 |
| Other securities issued or guaranteed by Canada not maturing within three years | **8,799.7** | 5,635.2 |
| Other investments | **3,434.1** | 3,942.4 |
| | **30,464.5** | 29,322.4 |
| **Bank premises** (note 4) | **189.0** | 198.2 |
| **Other assets** | **346.1** | 271.0 |
| | **31,749.2** | 30,584.4 |

**(See accompanying notes to the financial statements.)**

| LIABILITIES | 1997 | 1996 |
|---|---|---|
| | **Millions of dollars** | |
| **Capital paid up** (note 5) | **5.0** | 5.0 |
| **Rest fund** (note 6) | **25.0** | 25.0 |
| **Bank notes in circulation** | **30,542.0** | 29,109.1 |
| **Deposits** | | |
| Government of Canada | **40.6** | 11.0 |
| Chartered banks | **539.0** | 945.5 |
| Other members of the Canadian Payments Association | **24.6** | 14.6 |
| Other deposits | **278.3** | 347.8 |
| | **882.5** | 1,318.9 |
| **Liabilities in foreign currencies** | | |
| Government of Canada | **231.2** | 91.0 |
| **Other liabilities** | **63.5** | 35.4 |
| | **31,749.2** | 30,584.4 |

Governor, **G.G. THIESSEN**

Chief Accountant, **D.D. LUSBY**

On behalf of the Board

Chairman, Audit Committee, **W. Dubowec** FCA

Lead Director, **J. Maxwell**

# Bank of Canada
# Notes to the financial statements

## Year ended 31 December 1997

**1. Bank functions**

The Bank of Canada's primary responsibilities are set out in the Bank of Canada Act and can be grouped into four broad functions which are described below. Net operating expenses in the Statement of revenue and expense are reported on the basis of these four corporate functions. Net operating expenses by major objects of expenditure are presented in note 3.

**Monetary policy**

The Bank's most important responsibility is monetary policy. Monetary policy is concerned with managing the rate of monetary expansion in a way that is consistent with preserving the value of money.

**Central banking services**

The Bank carries out a variety of activities that regulate and support Canada's principal systems for clearing and settling payments and other financial transactions. The Bank also provides a number of central banking services and advice to the federal government, financial institutions, and the general public.

**Currency**

The Bank is responsible for issuing bank notes in Canada. This responsibility involves note design (including anti-counterfeiting features) as well as the printing and distribution of bank notes and their eventual replacement.

**Debt-management services**

**Market debt services**

As fiscal agent, the Bank advises the federal government on matters relating to the public debt and is responsible for issuing debt, maintaining bondholder records, and making payments on behalf of the government for interest and debt redemption.

**Retail debt services**

As fiscal agent, the Bank provides administrative, systems and operational support services to the Canada Investment and Savings Agency in support of the federal government's retail debt program and is responsible for issuing debt, maintaining bondholder records, and making payments on behalf of the federal government for interest and debt redemption. Effective June 1997, as a result of amendments to the Bank of Canada Act, the Bank began charging the Department of Finance with the full cost of retail debt operations.

**2. Significant accounting policies**

The financial statements of the Bank are in accordance with generally accepted accounting principles and conform to the disclosure and accounting requirements of the Bank of Canada Act and the Bank's by-laws. As all material changes in financial position are evident from the financial statements, a separate statement of changes in financial position has not been prepared as it would not provide any additional useful information. The significant accounting policies of the Bank are:

**a) Revenues and expenses**

Revenues and expenses are accounted for on the accrual basis, except for interest on advances to a bank ordered to be wound up which is recorded as received.

**b) Translation of foreign currencies**

Assets and liabilities in foreign currencies are translated to Canadian dollars at the rates of exchange prevailing at the year-end. Foreign currency assets and liabilities covered by forward contracts are converted to Canadian dollars at the contracted rates. Gains and losses from translation of, and transactions in, foreign currencies are included in revenue.

**c) Advances**

Advances to members of the Canadian Payments Association are liquidity loans for which the Bank charges the Bank Rate. These loans are fully collateralized and generally overnight in duration.

**d) Investments**

Investments, consisting mainly of Government of Canada treasury bills and bonds, are recorded at cost and are adjusted for amortization of purchase discounts and premiums. The amortization, as well as gains and losses on disposition, are included in revenue.

**e) Bank premises**

Bank premises, consisting of land, buildings, computer hardware/software, and other equipment, are recorded at cost less accumulated depreciation. Computer software is capitalized only when its cost exceeds $2 million. Depreciation is calculated using the straight-line method and is applied over the estimated useful lives of the assets, as shown below.

| | |
|---|---|
| Buildings | 25 to 40 years |
| Computer hardware/software | 3 to 7 years |
| Other equipment | 5 to 15 years |

A full year of depreciation is charged against assets in the year of acquisition, except for projects in progress which are depreciated from the point of substantial completion. No depreciation is taken on assets in the year of disposal.

**f) Deposits**

The liabilities within this category are generally Canadian dollar non-interest-bearing demand deposits.

**g) Insurance**

The Bank does not insure against direct risks of loss to the Bank, except for potential liabilities to third parties and where there are legal or contractual obligations to carry insurance. Any costs arising from these risks are recorded in the accounts at the time they can be reasonably estimated.

## 3. Expense by object of expenditure

| | 1997 | 1996 |
|---|---|---|
| | **Millions of dollars** | |
| Salaries | **72.3** | 71.3 |
| Benefits and other staff expenses | **17.7** | 23.4 |
| Currency costs | **18.4** | 16.8 |
| Premises maintenance, net of rental income | **26.1** | 28.0 |
| Services and supplies | **30.7** | 19.5 |
| Depreciation | **22.3** | 23.4 |
| | **187.5** | 182.4 |
| Recoveries | | |
| Retail debt services | **(28.9)** | - |
| Other | **(2.8)** | (3.4) |
| | **155.8** | 179.0 |
| Other expenses (revenue) | | |
| Settlement cost | **-** | 22.3 |
| Workforce adjustment (note 8) | **2.5** | 5.0 |
| Miscellaneous | **(14.1)** | 7.4 |
| Total | **144.2** | 213.7 |

Salaries and benefits of Bank staff engaged in premises maintenance are not included in the *Salaries* or *Benefits and other staff expenses* categories, but rather as part of *Premises* expenses.

Recoveries represent the fees charged by the Bank for a variety of services. Effective June 1997, the Bank began recovering the cost of retail debt operations from the Canada Investment & Savings Agency on a full cost basis.

Miscellaneous expenses (revenue) for 1997 include a net book gain of $10.1 million related to the sale of four Bank buildings outside of Ottawa, namely Halifax, Regina, Calgary and Vancouver. As well, the Bank received payment for out-of-pocket expenses of $4.0 million incurred in connection with the liquidation of the Canadian Commercial Bank (note 10).

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.

**4. Bank premises**

| | **1997** | | | **1996** | | |
|---|---|---|---|---|---|---|
| | **Millions of dollars** | | | | | |
| | Cost | Accumulated depreciation | Net book value | Cost | Accumulated depreciation | Net book value |
| Land and buildings | **201.0** | **88.2** | **112.8** | 224.0 | 97.6 | 126.4 |
| Computer hardware/software | **36.1** | **24.0** | **12.1** | 39.1 | 26.3 | 12.8 |
| Other equipment | **132.5** | **83.0** | **49.5** | 138.7 | 85.7 | 53.0 |
| | **369.6** | **195.2** | **174.4** | 401.8 | 209.6 | 192.2 |
| Projects in progress | **14.6** | **–** | **14.6** | 6.0 | – | 6.0 |
| | **384.2** | **195.2** | **189.0** | 407.8 | 209.6 | 198.2 |

**5. Capital paid up**

The authorized capital of the Bank is $5.0 million divided into 100,000 shares with a par value of $50 each. The shares are fully paid and, in accordance with the Bank of Canada Act, have been issued to the Minister of Finance, who is holding them on behalf of the Government of Canada.

**6. Rest fund**

The rest fund was established in accordance with the Bank of Canada Act and represents the general reserve of the Bank. The rest fund was accumulated out of net revenue until it reached the stipulated maximum amount of $25.0 million in 1955.

**7. Investments**

This category includes Government of Canada treasury bills and bonds as well as other investments which are held under short-term foreign currency swap arrangements with the Exchange Fund Account of the Government of Canada as described in note 11(b).

The Bank typically holds its investments in treasury bills and bonds until maturity. The amortized book values of these investments approximate their par values. At the year-end, the average yield on the Bank's holdings of treasury bills which average three months to maturity was 3.9 per cent (3.6 per cent in 1996), while the average yield for bonds maturing within three years was 6.6 per cent (7.5 per cent in 1996), and for those maturing in over three years was 7.8 per cent (9.1 per cent in 1996).

**8. Workforce adjustment**

Following extensive reviews of its activities, the Bank has been streamlining a number of its operations resulting in an expected total reduction of about 650 of its staff positions. The position reductions are being accomplished through early retirements, voluntary departures and layoffs, and will be completed in 1998. To record termination costs, the Bank made provisions for $33 million in its accounts in 1995, $5 million in 1996 and $2.5 million in 1997. As at 31 December 1997, $31.4 million of the provision of $40.5 million had been paid.

**9. Pension plan**

The Bank sponsors a defined-benefit pension plan for its employees which is registered under the Pension Benefits Standards Act. The plan provides pension benefits based on length of service and rates of pay.

Actuarial valuations of the pension plan are made periodically by an independent actuary using the projected benefit method prorated on service. Market-related values are used to value pension plan assets. Based on the latest actuarial valuation as at 31 December 1995, the estimated present value of the accrued pension benefits as at 31 December 1997 was $423.6 million ($418.8 million in 1996), and the estimated market-related value of the pension plan assets was $508.8 million ($468.9 million in 1996).

Pension expense for 1997 was in a credit position of $1.3 million ($7.0 million expense in 1996). These amounts comprise the actuarially computed cost of pension benefits in respect of current year service and the amortization of past service costs and experience gains and losses. Amortization is calculated on a straight-line basis over the average remaining service life of the plan members, currently 12 years.

**10. Legal matters**

On 3 September 1985 and 20 January 1986 respectively, winding up orders were issued for the Canadian Commercial Bank and the Northland Bank. At those dates, the Bank of Canada had liquidity advances outstanding of $1.3 billion to the Canadian Commercial Bank and $0.5 billion to the Northland Bank.

At 31 December 1997, the residual balance of the advance outstanding was $1 million to the Northland Bank (unchanged from 1996). On the basis of the available information, it is the opinion of the Bank of Canada that it will be fully repaid from the proceeds of the liquidation of Northland Bank.

As a result of a court order issued in December 1997 concerning the Canadian Commercial Bank, the Bank of Canada received payment of the residual balance of the advance outstanding of $45.3 million together with interest of $43.9 million and out-of-pocket expenses of $4.0 million. This brings the total amount received by the Bank of Canada in satisfaction of its claim as a secured creditor of the Canadian Commercial Bank to $1.5 billion.

An amount of $13.8 million remaining to be paid to the Bank of Canada as part of the settlement with unsecured creditors of the Canadian Commercial Bank is reported under Other assets on the Balance sheet. The Bank of Canada expects to receive $10 million of this amount before the end of March 1998.

**11. Commitments**

**a) Bank premises**

As at 31 December 1997, outstanding commitments under contracts for new computer systems and equipment purchases totalled $9.0 million ($9.1 million in 1996). These contracts call for payments over the next year.

**b) Foreign currency contracts**

In the ordinary course of business, the Bank enters into commitments involving the purchase and sale of foreign currencies. In particular, the Bank enters into short-term foreign currency swap arrangements with the Exchange Fund Account (EFA) of the Government of Canada as part of its cash management operations within the Canadian banking system. These transactions, which are made with the concurrence of the Minister of Finance under a standing authority, involve the temporary acquisition by the Bank of foreign currency investments from the EFA. These investments are paid for in Canadian dollars at the prevailing exchange rate with a commitment to reverse the transaction at the same rate of exchange at a future date. The fair values of these investments are not materially different from their book values. At the year-end, the average yield for these investments was 6.1 per cent (6.1 per cent in 1996).

As well, the Bank of Canada is a participant in two foreign currency swap facilities with foreign central banks. The first, amounting to U.S.$2 billion, is with the U.S. Federal Reserve. The second, amounting to Can.$1 billion, is with the Banco de México. There were no drawings under either facility in 1996 or 1997.

A summary of outstanding commitments follows.

| | | **1997** | **1996** |
|---|---|---|---|
| | | **Millions of dollars** | |
| Foreign currency contracts | - purchases | **95.8** | 75.4 |
| | - sales | **3,573.8** | 4,080.5 |

As at 31 December 1997, outstanding foreign currency contracts included sale commitments of $3,476.2 million ($4,005.1 million in 1996) under swap arrangements with the EFA.

**12. Year 2000**

In April 1997, the Bank completed an internal Year 2000 impact assessment. Based on the results of this study, the Bank has developed a business plan to ensure that its critical internal systems will function properly, to co-ordinate testing with business partners of shared systems, and to ensure that appropriate contingency plans are in place in the event of disruption or system failure.

The plan is designed to ensure continued and proper functioning of the payments and settlement systems, monetary policy operations, bank note operations and debt-management services. A dedicated team has been formed to provide overall management, direction and support of the Year 2000 initiatives.

The Bank's plan is to have internal systems completed by the end of 1998. In 1999, the Bank will focus on testing shared systems with its business partners and developing the necessary contingency plans. The Bank estimates that the total cost of external and internal resources for this initiative will be approximately $14.0 million over the period from 1997 to 1999, with $2.0 million of this amount incurred in 1997.