Financial Statements

YEAR ENDED 31 DECEMBER 1998

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 fulfills 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 auditor, 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

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

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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 1998 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 1998 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
22 January 1999

Bank of Canada
Statement of revenue and expense

Year ended 31 December 1998

	1998	1997
	Millions of dollars	
REVENUE		
Revenue from investments	**1,799.4**	1,578.6
EXPENSE by function (notes 1 and 3)		
Monetary policy	**40.7**	37.6
Currency	**56.0**	65.7
Central banking services	**32.2**	33.7
	128.9	137.0
Retail debt services - expenses	**65.5**	47.7
Retail debt services - recoveries	**(65.5)**	(28.9)
Other revenue - net	**(8.3)**	(11.6)
	120.6	144.2
NET REVENUE PAID TO RECEIVER GENERAL FOR CANADA	**1,678.8**	1,434.4

(See accompanying notes to the financial statements.)

Bank of Canada
Balance sheet

As at 31 December 1998

ASSETS	1998	1997
	Millions of dollars	
Deposits in foreign currencies		
U.S. dollars	**321.1**	383.1
Other currencies	**6.2**	3.2
	327.3	386.3
Advances to members of the Canadian Payments Association	**655.7**	363.3
Investments (note 8)		
Treasury bills of Canada	**10,563.8**	14,065.0
Other securities issued or guaranteed by Canada maturing within three years	**6,302.2**	4,165.7
Other securities issued or guaranteed by Canada not maturing within three years	**10,880.1**	8,799.7
Other investments	**4,455.7**	3,434.1
	32,201.8	30,464.5
Bank premises (note 4)	**188.0**	189.0
Other assets (note 5)	**436.4**	346.1
	33,809.2	31,749.2

(See accompanying notes to the financial statements.)

LIABILITIES	1998	1997
	Millions of dollars	
Capital paid up (note 6)	**5.0**	5.0
Rest fund (note 7)	**25.0**	25.0
Bank notes in circulation	**32,637.5**	30,542.0
Deposits		
Government of Canada	**10.6**	40.6
Chartered banks	**578.7**	539.0
Other members of the Canadian Payments Association	**73.5**	24.6
Other deposits	**243.7**	278.3
	906.5	882.5
Liabilities in foreign currencies		
Government of Canada	**162.0**	231.2
Other liabilities	**73.2**	63.5
	33,809.2	31,749.2

Governor, G.G. Thiessen

Chief Accountant, F.J. Mahoney

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 1998

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. Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year. Net operating expenses by major classes 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.

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.

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. The Bank advises the federal government on matters relating to the public debt and is responsible for issuing market 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 systems and operational support services to the Canada Investment and Savings agency (CI&S) 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. The Bank recovers the cost of retail debt operations on a full cost basis. Recoveries from the federal government began with amendment of the Bank of Canada Act, effective June 1997.

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 held under short-term foreign currency swap arrangements with the Exchange Fund Account of the Government of Canada, as described in note 11(a), 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, is 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

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 classes of expenditure

	1998	1997
	Millions of dollars	
Salaries	**77.2**	72.3
Benefits and other staff expenses	**14.8**	17.7
Currency costs	**14.8**	18.4
Premises maintenance, net of rental income	**22.2**	26.1
Services and supplies	**43.4**	30.7
Depreciation	**23.7**	22.3
	196.1	187.5
Recoveries		
Retail debt services	**(65.5)**	(28.9)
Other	**(1.7)**	(2.8)
	128.9	155.8
Other expenses (revenue)		
Workforce adjustment (note 9)	**1.0**	2.5
Miscellaneous	**(9.3)**	(14.1)
Total	**120.6**	144.2

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.

Miscellaneous revenue for 1998 and 1997 principally reflects net book gains on the sale of Bank buildings.

4. Bank premises

	1998			1997		
	Millions of dollars					
	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
Land and buildings	**168.0**	**65.1**	**102.9**	201.0	88.2	112.8
Computer hardware/software	**61.6**	**24.6**	**37.0**	36.1	24.0	12.1
Other equipment	**136.5**	**88.4**	**48.1**	132.5	83.0	49.5
	366.1	**178.1**	**188.0**	369.6	195.2	174.4
Projects in progress	**–**	**–**	**–**	14.6	–	14.6
	366.1	**178.1**	**188.0**	384.2	195.2	189.0

5. Other assets

This category includes accrued interest on investments of $352.1 million ($286.4 million in 1997).

6. 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.

7. 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.

8. 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(a).

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 5.0 per cent (3.9 per cent in 1997), while the average yield for bonds maturing within three years was 6.6 per cent (6.6 per cent in 1997), and for those maturing in over three years was 6.9 per cent (7.8 per cent in 1997).

9. Workforce adjustment

Following extensive reviews of its activities, the Bank has streamlined a number of its operations resulting in a total reduction of approximately 640 of its staff positions over the past 3 years. The position reductions have been accomplished through early retirements and voluntary departures, as well as staff layoffs concentrated at the Bank's agency locations across Canada where redeployment opportunities were limited. To record termination costs, the Bank made provisions in its accounts of $33 million in 1995, $5 million in 1996, and $2.5 million in 1997. As at 31 December 1998, when the workforce adjustment program ended, the total cost of the program was $41.5 million compared with the provision of $40.5 million. The difference was included in expenses for 1998.

10. 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 1998 was $449.6 million ($436.5 million in 1997), and the estimated market-related value of the pension plan assets was $565.5 million ($512.3 million in 1997).

Pension expense for 1998 was in a credit position of $4.3 million ($1.3 million in 1997). 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 expected average remaining service life of the plan members, currently 12 years.

11. Commitments

a) 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 6.0 per cent (6.1 per cent in 1997).

As well, the Bank of Canada is a participant in two foreign currency swap facilities with foreign central banks. The first, amounting to US$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 1998 or 1997.

A summary of outstanding commitments follows.

		1998	**1997**
		Millions of dollars	
Foreign currency contracts	- purchases	**95.6**	95.8
	- sales	**4,644.3**	3,573.8

As at 31 December 1998, outstanding foreign currency contracts included sale commitments of $4,548.7 million ($3,476.2 million in 1997) under swap arrangements with the EFA.

b) Investment contracts

In the ordinary course of business, the Bank enters into commitments involving the purchase and sale of securities. A summary of these outstanding commitments follows.

		1998	1997
		Millions of dollars	
Investment contracts	- purchases	**1,552.5**	-
	- sales	**-**	-

As at 31 December 1998, outstanding investment contracts included purchase commitments of $1,552.5 million under Sale and Repurchase Agreements (nil at the end of 1997) which were settled on 4 January 1999.

12. Year 2000

The year-2000 computer issue arises chiefly because many date-sensitive automated systems have not been designed to recognize correctly the year 2000. This represents a significant challenge for all organizations. If not addressed properly, the year-2000 issue could have an impact on operations and financial reporting, ranging from minor errors to the failures of critical systems. The effects of the year-2000 issue could be experienced before, as well as on or after, 1 January 2000. Despite best efforts, it is not possible to be certain that all aspects of the year-2000 issue affecting the Bank, including those related to the efforts of clients, suppliers, or other third parties, will be fully resolved.

The Bank of Canada has a business plan for dealing with the year-2000 issue. The objectives of that plan are to ensure that the Bank's critical internal systems will function properly, to coordinate with business partners the testing of shared systems, and to ensure that appropriate contingency plans are in place in the event of disruptions or system failures. Since 1997, the Bank has had a team assigned solely to implementation of the plan, which entails the overall management, direction, and support of year-2000 initiatives.