FINANCIAL **STATEMENTS**

(Year ended 31 December 2001)

BANK OF CANADA

FINANCIAL REPORTING RESPONSIBILITY

The accompanying financial statements of the Bank of Canada have been prepared by management in accordance with Canadian generally accepted accounting principles. 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 that 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, Raymond Chabot Grant Thornton, General Partnership and Arthur Andersen LLP, and their report is presented herein.

D.A. Dodge, Governor

D.W. MacDonald, Chief Administrative Officer

Ottawa, Canada

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

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 2001 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 Canadian 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 2001 and the results of its operations for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at 31 December 2000 and for the year then ended were audited by Caron Bélanger Ernst & Young and Raymond Chabot Grant Thornton, General Partnership, who expressed an opinion without reservation in their report dated 16 January 2001.

Raymond Chabot Grant Thornton

RAYMOND CHABOT GRANT THORNTON
General Partnership
Chartered Accountants

Arthur Andersen LLP

ARTHUR ANDERSEN LLP

Chartered Accountants

Ottawa, Canada
18 January 2002

BANK OF CANADA

STATEMENT OF REVENUE AND EXPENSE

Year ended 31 December 2001

	2001	2000
	Millions of dollars	
REVENUE		
Revenue from investments, net of interest paid on deposits of $23.2 million ($42.8 million in 2000)	**2,149.2**	2,111.0
EXPENSE by function (notes 1 and 3)		
Monetary policy	**43.4**	38.8
Currency	**65.6**	48.5
Central banking services	**31.1**	31.3
	140.1	118.6
Retail debt services – expenses	**73.6**	75.6
Retail debt services – outsourcing costs (note 11)	**23.2**	-
Retail debt services – recoveries	**(96.8)**	(75.6)
	140.1	118.6
OTHER EXPENSE		
Restructuring costs (note 11)	**28.7**	-
	168.8	118.6
NET REVENUE PAID TO RECEIVER GENERAL FOR CANADA	**1,980.4**	1,992.4

(See accompanying notes to the financial statements.)

BANK OF CANADA

BALANCE SHEET

As at 31 December 2001

ASSETS	2001	2000
	Millions of dollars	
Deposits in foreign currencies		
U.S. dollars	**391.9**	742.0
Other currencies	**3.8**	4.9
	395.7	746.9
Advances to members of the Canadian Payments Association	**647.5**	952.3
Investments (note 4)		
Treasury bills of Canada	**12,605.6**	9,134.7
Other securities issued or guaranteed by Canada maturing within three years	**8,799.8**	8,342.5
Other securities issued or guaranteed by Canada not maturing within three years	**16,976.7**	15,293.8
Other bills	**428.8**	1,666.7
Other investments	**2.6**	1,500.3
	38,813.5	35,938.0
Bank premises (note 5)	**149.2**	162.8
Other assets		
Securities purchased under resale agreements	**1,410.7**	1,357.5
All other assets (note 6)	**387.9**	390.6
	1,798.6	1,748.1
	41,804.5	39,548.1

(See accompanying notes to the financial statements.)

LIABILITIES AND CAPITAL

	2001	2000
	Millions of dollars	
Capital paid up (note 7)	**5.0**	5.0
Rest fund (note 8)	**25.0**	25.0
Bank notes in circulation	**38,820.6**	36,775.3
Deposits		
Government of Canada	**1,005.2**	16.1
Banks	**1,307.1**	1,669.2
Other members of the Canadian Payments Association	**23.8**	101.8
Other deposits	**289.6**	267.0
	2,625.7	2,054.1
Liabilities in foreign currencies		
Government of Canada	**224.6**	584.4
Other liabilities		
Securities sold under repurchase agreements	–	–
All other liabilities	**103.6**	104.3
	103.6	104.3
	41,804.5	39,548.1

D.A. Dodge, Governor

S. Vokey, CA, Chief Accountant

On behalf of the Board

J.S. Lanthier, CM, FCA, Chair, Audit Committee

H.H. MacKay, QC, Lead Director

(See accompanying notes to the financial statements.)

BANK OF CANADA

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2001

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. Expenses in the *Statement of revenue and expense* are reported on the basis of these four corporate functions.

Monetary policy

The goal of monetary policy is to contribute to solid economic performance and rising living standards for Canadians by keeping inflation low, stable, and predictable.

Currency

The Bank issues Canada's bank notes and is responsible for note design (including anti-counterfeiting features), the distribution of new notes, and the replacement of worn notes.

Central banking services

This function involves two major activities: the promotion of financial stability and the provision of efficient funds-management services to the federal government.

Retail debt services

The Bank is responsible for ensuring that all holders of Canada Savings Bonds and Canada Premium Bonds have their information registered and their accounts serviced through efficient operations and systems support. The Bank recovers the cost of retail debt operations on a full-cost basis.

2. Significant accounting policies

The financial statements of the Bank are in accordance with Canadian generally accepted accounting principles and conform to the disclosure and accounting requirements of the Bank of Canada Act and the Bank's bylaws. A *Statement of cash flows* has not been prepared as the liquidity and cash position of the Bank are not of primary concern to users of these financial statements. Other information regarding the Bank's activities may be derived from the *Statement of revenue and expense* and the *Balance sheet*.

The significant accounting policies of the Bank are:

a) Accounting estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the financial statements and notes to financial statements. These estimates are based on management's best knowledge of current events and actions that the Bank may undertake in the future. Actual results may differ from those estimates.

b) Revenues and expenses

Revenues and expenses are accounted for on the accrual basis.

c) Employee benefit plans

The Bank sponsors a number of defined benefit plans that provide pension and other post-retirement and post-employment benefits to most of its employees. The Bank accrues its obligations under these benefit plans and the related costs, net of plan assets. The costs of the plans are actuarially determined using the projected benefit method to determine the current service costs. Past service costs resulting from plan amendments, and the transitional balances are amortized on a straight-line basis over the average remaining service period of active plan members (12 years). The excess of the net actuarial gain (loss) over 10 per cent of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active plan members (12 years). For the purpose of calculating the expected return on plan assets, assets are valued at fair value.

Changes resulting from adoption as at 1 January 2000 of the new accounting standards for employee benefits have been applied on a prospective basis.

d) Translation of foreign currencies

Assets and liabilities in foreign currencies are translated to Canadian dollars at the rates of exchange prevailing at 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 10(b), are converted to Canadian dollars at the contracted rates. Gains and losses from translation of, and transactions in, foreign currencies are included in revenue.

e) Advances

Advances to members of the Canadian Payments Association are liquidity loans that are fully collateralized and generally overnight in duration. The Bank charges interest on advances under the Large Value Transfer System LVTS at the Bank Rate. For advances under the Automated Clearing Settlement System ACSS, the Bank charges the Bank Rate plus a margin, which was 150 basis points at 31 December 2001 (150 basis points in 2000).

f) 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 using the constant yield method for treasury bills and bankers' acceptances and the straight-line method for bonds. The amortization, as well as gains and losses on disposition, are included in revenue.

g) 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

h) Special purchase and resale agreements (SPRAs)

SPRAs are repo-type transactions in which the Bank offers to purchase Government of Canada securities from designated counterparties with an agreement to sell them back at a predetermined price on the agreed resale date, generally the next business day. The Bank is prepared to enter into SPRAs at the policy target rate, defined as the midpoint of the operating band for the overnight interest rate (i.e., 25 basis points below the Bank Rate), if overnight funds are generally trading above the indicated target level. SPRAs are transacted with primary dealers, a subgroup of government securities distributors that have reached a threshold level of activity in the Government of Canada debt markets.

The balance sheet category *Securities purchased under resale agreements* represents the value receivable by the Bank. As such, this amount includes the purchase of treasury bills and bonds, the purchase of accrued interest on bonds, and the interest earned by the Bank. The treasury bills and bonds purchased under resale agreements are not recorded as investment assets.

i) Deposits

The liabilities within this category are Canadian dollar demand deposits. For members of the Canadian Payments Association, the Bank pays interest on positive balances associated with the LVTS at the lower end of the operating band for the overnight interest rate (50 basis points below the Bank Rate), and on positive balances related to the ACSS at the lower end of the operating band for the overnight interest rate less a margin, which was 150 basis points at 31 December 2001 (150 basis points in 2000). On Special Deposit Accounts, which serve as collateral for LVTS participants, the Bank pays interest at the published overnight rate less a margin, which was 6.25 basis points at 31 December 2001 (6.25 basis points in 2000).

j) Sale and repurchase agreements (SRAs)

SRAs are reverse repo-type transactions in which the Bank offers to sell Government of Canada securities to designated counterparties with an agreement to buy them back at a predetermined price the next business day. The Bank is prepared to enter into SRAs at the policy target rate, defined as the midpoint of the operating band for the overnight interest rate (i.e., 25 basis points below the Bank Rate), if overnight funds are generally trading below the indicated target level. SRAs are transacted with primary dealers, a subgroup of government securities distributors that have reached a threshold level of activity in the Government of Canada debt markets.

The balance sheet category *Securities sold under repurchase agreements* represents the value payable by the Bank. As such, this amount includes the sale of treasury bills and bonds, the sale of accrued interest on bonds, and the interest owed by the Bank. The treasury bills and bonds sold under repurchase agreements continue to be recorded as investment assets.

k) 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

	2001	2000
	Millions of dollars	
Salaries	**83.4**	93.6
Benefits and other staff expenses	**13.8**	15.7
Currency costs	**24.6**	10.0
Premises maintenance	**18.9**	18.5
Services and supplies	**54.3**	36.9
Depreciation	**26.3**	26.0
	221.3	200.7
Outsourcing costs	**23.2**	–
Recoveries		
Retail debt services	**(96.8)**	(75.6)
Other	**(7.6)**	(6.5)
	140.1	118.6
Restructuring costs	**28.7**	–
Total	**168.8**	118.6

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

Recoveries represent the fees charged by the Bank for a variety of services. Retail debt services recoveries for 2001 include outsourcing costs.

4. 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 10(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 year-end, the average yield on the Bank's holdings of treasury bills, which average three months to maturity, was 3.3 per cent (5.8 per cent in 2000). The average yield for bonds maturing within three years was 6.0 per cent (6.4 per cent in 2000), and for those maturing in over three years it was 6.3 per cent (6.5 per cent in 2000). The average yield for other bills, which average less than one month to maturity, was 2.3 per cent (5.8 per cent in 2000). The total fair value of investments is $40,385.6 million ($37,198.9 million in 2000).

5. Bank premises

	2001			**2000**		
	Millions of dollars					
	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
Land and buildings	**167.5**	**74.9**	**92.6**	168.0	71.9	96.1
Computer hardware/ software	**57.0**	**37.4**	**19.6**	63.0	37.2	25.8
Other equipment	**139.4**	**102.4**	**37.0**	139.0	98.1	40.9
	363.9	**214.7**	**149.2**	370.0	207.2	162.8

6. All other assets

This category includes accrued interest on investments of $279.0 million ($305.1 million in 2000).

7. 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.

8. 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.

9. Employee benefit plans

The Bank sponsors a number of defined benefit plans that provide pension and other post-retirement and post-employment benefits to most of its employees. The following table provides information about these plans.

	Pension benefit plan		Other benefit plans	
	2001	2000	2001	2000
	Millions of dollars		Millions of dollars	
For the year				
Bank contributions	**2.0**	1.4	**5.7**	2.6
Employees' contributions	**0.4**	0.3	**0.0**	0.0
Benefits paid	**20.8**	19.8	**5.7**	2.6
Benefit plan expense (revenue)	**(15.1)**	(12.3)	**14.7**	11.8
Curtailment loss	–	–	**8.9**	–

	Pension benefit plan		Other benefit plans	
	2001	2000	2001	2000
	Millions of dollars		Millions of dollars	
As at 31 December				
Accrued benefit obligation	**486.4**	444.2	**87.4**	88.6
Fair value of plan assets	**632.6**	657.8	**0.0**	0.0
Funded status-plan surplus (deficit)	**146.2**	213.6	**(87.4)**	(88.6)
Accrued benefit asset (liability)	**55.6**	39.0	**(41.0)**	(23.1)

The significant actuarial assumptions (weighted averages as of 31 December) used in calculating the accrued benefit obligations are as follows.

	Pension benefit plan		Other benefit plans	
	2001	2000	2001	2000
Discount rates	**5.75%**	6.11%	**5.99%**	6.05%
Expected rates of return on plan assets for the year	**5.70%**	6.06%	**N/A**	N/A
Rate of compensation increase	**3.00% + merit**	3.00% + merit	**3.00% + merit**	3.00% + merit

Interest rates for Government of Canada marketable bonds are used. These rates are different than those employed by the Bank for funding valuations of the *pension benefit plan*.

For measurement purposes, a 9.0 per cent annual rate of increase in the per capita cost of covered hospital and drug benefits was assumed. The rate was assumed to decrease gradually to 4.5 per cent over 10 years and remain at that level thereafter. The per capita cost of other health care benefits was assumed to increase at 3.0 per cent per annum.

10. Commitments

a) Operations

The Bank has entered into a long-term support agreement for retail debt services, expiring in 2011, that calls for fixed payments totalling $136.7 million and a variable component based on the volume of transactions. The Bank recovers the cost of retail debt services from the Canada Investment and Savings Agency.

Commitments related to other support services are $9.7 million over the next three years.

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 year-end, there were no investments held by the Bank under this arrangement. At the end of 2000, the average yield for these investments was 6.1 per cent.

As well, the Bank 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 2001 or 2000.

All commitments outstanding at 31 December are settled in the subsequent year.

A summary of these outstanding commitments follows.

		2001	**2000**
		Millions of dollars	
Foreign currency contracts	– purchases	**165.4**	133.0
	– sales	**165.4**	1,654.5

At 31 December 2001, there were no outstanding foreign currency contracts included in sale commitments ($1,521.5 million in 2000) under swap arrangements with the EFA.

c) Investment contracts

In the ordinary course of business, the Bank enters into commitments involving the purchase and sale of securities. All commitments outstanding at 31 December are settled in the subsequent year. A summary of these outstanding commitments follows.

		2001	2000
		Millions of dollars	
Investment contracts	– purchases	–	–
	– sales	**1,411.1**	1,358.3

Outstanding sale investment contracts of $1,411.1 million, at an interest rate of 2.25 per cent under special purchase and resale agreements, were settled by 8 January 2002 ($1,358.3 at the end of 2000 at an interest rate of 5.75 per cent).

11. Retail debt outsourcing and corporate services restructuring

In 2000, the Bank launched a major initiative to investigate options for the appropriate arrangements to provide operations and systems support for the federal government's retail debt program. As a result of its studies, the Bank began a process to outsource support for the program to a private sector supplier, while maintaining its role as fiscal agent for retail debt. In 2001, the Bank signed a contract with EDS Canada for the provision of operations and systems support. The contract is for a term of 9.5 years and commenced 1 September 2001. Under the contract, Bank staff joined EDS in its Ottawa offices. The total one-time cost of outsourcing associated with this initiative was $23.2 million, all of which is recoverable from the Canada Investment and Savings Agency of the federal government.

With the outsourcing initiative completed, the Bank has undertaken to restructure its corporate services to align them with the needs of a smaller organization. This restructuring program is scheduled for completion in 2003. The cost of restructuring in 2001 is $28.7 million, which includes an accrual of $5.8 million for staff redundancies expected in 2002, as well as a curtailment loss from post-retirement benefits (note 9).