Nova Scotia Farm Loan Board

Financial Statements
March 31, 2011

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June 30, 2011

Independent Auditor's Report

To the Members of the Legislative Assembly; and
To the Minister of Agriculture

We have audited the accompanying financial statements of the **Nova Scotia Farm Loan Board** (the "Board") which comprise the balance sheet as at March 31, 2011 and the statements of operations and equity for the year then ended and the related notes including a summary of significant accounting policies.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Board as at March 31, 2011 and the results of its operations for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Nova Scotia Farm Loan Board

Balance Sheet

As at March 31, 2011

(in thousands of dollars)

	2011 $	2010 $
Assets		
Restricted cash (note 3)	934	1,410
Interest and other receivables, net (note 4)	2,344	2,695
Loans receivable (note 5)	153,224	152,573
Real estate, net (note 6)	5,641	4,088
	162,143	160,766
Liabilities		
Due to the Province of Nova Scotia	934	1,765
Advances from the Province of Nova Scotia (note 8)	161,209	159,001
	162,143	160,766
Equity	–	–
	162,143	160,766

Commitments (note 15)

Approved on behalf of the Board of Directors

____________________ Member ____________________ Member

Nova Scotia Farm Loan Board

Statement of Operations

For the year ended March 31, 2011

(in thousands of dollars)

	2011 $	2010 $
Revenue		
Interest on loans	8,978	9,426
Loan processing and other fees	699	584
	9,677	10,010
Expenses		
Interest	8,928	9,264
Life insurance program expense, net (note 11)	275	170
Operating expenses (note 10)	1,477	1,288
Bad debt (note 7)	656	4,664
	11,336	15,386
Deficit before government contributions	(1,659)	(5,376)
Government contributions (note 12)	1,659	5,376
	–	–

Nova Scotia Farm Loan Board

Statement of Equity

For the year ended March 31, 2011

(in thousands of dollars)

	2011 $	2010 $
Equity – Beginning of year	–	–
Deficit before government contributions	(1,659)	(5,376)
Government contributions (note 12)	1,659	5,376
Equity – End of year	–	–

(in thousands of dollars)

1 Authority

Nova Scotia Farm Loan Board ("the Board") provides loans to the agriculture and forestry sector for farms operating in rural Nova Scotia.

The Board is a provincial agency and operates under the authority of the Agriculture and Rural Credit Act and the Forests Act (for timber loans).

Principal in loans outstanding is limited by regulation to $200 million. Maximum advances to be disbursed in any given year, is established through the annual budgeting process. For the year ended March 31, 2011, maximum new advances were $30 million, of which $27.8 million was advanced. The Board received loan principal repayments of $32.6 million during the year.

Loans in excess of $2 million and any loan write-offs require approval by Governor in Council.

2 Capital management

As an agency of the Province of Nova Scotia, the Board does not maintain its own capital. Operations are funded by capital contributions from the Province.

3 Significant accounting policies

Restricted cash

The Board operates as an agency of the Province of Nova Scotia. All cash is received and disbursed through accounts managed centrally by the Province.

Restricted cash reported consists of funds held by Sun Life Assurance Company of Canada in relation to the Board's Creditor Group Life Insurance Program.

Statement of cash flows

Except for funds held by the insurance carrier, the Board holds no cash. Disbursements are drawn and receipts are deposited to accounts managed by the Province. A statement of cash flows has not been provided because disclosure in the balance sheet and statement of operations is considered adequate.

Loans receivable

Loans receivable are the principal portion of loans outstanding, net of the provision for loan impairment.

Loans are classified as impaired when, in management's opinion, there is no longer reasonable assurance of the timely collection of the full amount of principal and interest.

(in thousands of dollars)

3 Significant accounting policies (continued)

Provision for loan impairment

The provision for loan impairment represents management's best estimate of losses due to impaired loans in the Board's portfolio. The provision is determined based on management's identification and evaluation of the problem accounts and estimated losses that exist in the remaining portfolio. These judgements are influenced by the composition and quality of the portfolio, general economic conditions, and conditions affecting specific commodities, as well as the Board policy to act as a patient lender, providing additional time for repayment where full future repayment appears reasonable.

The Board records a specific provision based on a loan-by-loan review. Impaired loans are valued at the lower of their recorded investment or the estimated net realizable amount of their underlying security.

In addition, the Board records a general provision equal to 0.9 % (2010 – 0.9%) of the portfolio not included in the specific reserve. This is an estimate of incurred but unidentifiable losses based on a review of historic loan write-offs on an industry sector basis.

Real estate

Real estate acquired through foreclosure and held for sale is initially recorded at the lower of the recorded investment in the foreclosed loan and the estimated fair value based on the resale value of the security held, less disposal costs.

Net operating costs incurred on real estate held for sale are added to the carrying value of the property. The related provision is used to adjust the carrying value to net realizable value, resulting in inclusion of these costs in bad debt expenses if the carrying value exceeds net realizable value.

The Board also holds land purchased under a Provincial "Landbank" program and under a Federal-Provincial "Agriculture and Rural Development Agreement" ("ARDA"). Both of these programs have ceased to exist; however, existing properties and leases continue with renewable five-year terms. Property acquired under these programs is valued at cost less the unamortized value of the Federal contribution to the ARDA program. The Federal contribution is amortized to other income when related properties are sold. Lease clients are entitled to purchase the related property at its original purchase cost.

Revenue recognition

Interest income is recorded on an accrual basis until such time as a loan is classified as impaired. The loan reverts to an accrual status when all provisions for impairment are reversed and the ultimate collection of the principal interest is reasonably assured.

All loan related fees are reported as revenue in the period in which they were earned.

(in thousands of dollars)

3 Significant accounting policies (continued)

Financial instruments

The Board is required to designate its financial instruments into one of the following five categories: (i) held for trading; (ii) available for sale; (iii) held to maturity; (iv) loans and receivables; or (v) other financial liabilities. All financial instruments are to be initially measured at fair value. Financial instruments classified as held-for-trading or available for sale are subsequently measured at fair value with any change in fair value recorded in the statement of operations or other comprehensive income. All other financial instruments are measured at amortized cost using the effective interest method.

The Board's financial instruments consist of restricted cash, accrued interest and other accounts receivable and loans receivable. With the exception of loans receivable and interest and other receivables, which have been designated as loans and receivables, the Board's financial instruments have been designated as held for trading. Transaction costs related to loans are recorded as part of the total amount outstanding. The carrying value of loans receivable approximates its net realizable value. The Board holds all loans to maturity.

Management estimates

Canadian generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. By their nature, as described in note 5, these estimates are subject to measurement uncertainty and any changes in those estimates could have an impact on the results of future period financial statements.

Future accounting changes

Public Sector Accounting Standards ("PSAS")

The Canadian Accounting Standards Board announced that Canadian generally accepted accounting principles ("GAAP") for publicly accountable enterprises will be replaced by Public Sector Accounting Standards ("PSAS") for fiscal years beginning on or after January 1, 2012. The Board has determined that Public Sector Accounting Standards will be appropriate GAAP for accounting periods after that date. Some of the standards are still under development by the Public Sector Accounting Board and the Loan Board is currently assessing the impact of PSAS on its financial statements.

(in thousands of dollars)

4 Interest and other receivables (net)

	2011 $	2010 $
Interest receivable	1,867	2,122
Accrued interest	1,182	1,626
Other charges	248	290
	3,297	4,038
Less: Provision for impairment on impaired loans	746	1,343
Provision for impairment on real estate	207	–
	2,344	2,695

5 Loans receivable

a) Allowance for impaired loans

Loans are considered impaired when there has been a deterioration in credit quality to the extent the Board no longer has reasonable assurance of timely collection of the full amount of principal and interest. The allowance is comprised of two components, the specific allowance for individually identified impaired loans and a general allowance for impaired loans.

The specific allowance for individually identified impaired loans was established based upon a review of a large sample of impaired loans. Primary factors considered in estimating the specific allowance on individual loans were the security pledged and the financial condition of the borrower and/or, where applicable, guarantors.

The general allowance for impaired loans is management's best estimate of the loss that is likely to be experienced on impaired loans that were not known to be impaired at the year-end. The general allowance was determined based on management's judgment and recent experience by calculating the average estimated historical loss ratio by loan type and then applying these ratios to the current portfolio of unimpaired loans.

Significant judgment was exercised by management in making these estimates. As such, actual losses that occur on loans outstanding at March 31, 2011 will differ from these estimates and the differences could be material. Management estimates that the actual realization of impaired loans could result in significant variance from the estimated amounts.

(in thousands of dollars)

5 Loans receivable (continued)

a) Allowance for impaired loans (continued)

	2011		2010	
	Impaired loans $	**Allowance for impairment $**	**Impaired loans $**	**Allowance for impairment $**
Specific allowance	35,821	6,600	47,865	14,624
General allowance	–	1,071	–	989
	35,821	7,671	47,865	15,613

b) Continuity of allowance for impaired loans

	2011 $	2010 $
Allowance for impaired loans – Beginning of year	16,956	14,725
Add: Provision for impaired loans	448	4,133
Add: Provision for changes in restructured loan balances	475	–
Less: Loans written-off	(9,462)	(1,902)
Allowance for impaired loans – End of year	8,417	16,956
Provision on principal	7,671	15,613
Provision for interest	746	1,343
	8,417	16,956

(in thousands of dollars)

6 Real estate (net)

	2011 $	2010 $
Real estate held for long-term use		
Land bank	411	565
Agriculture and Rural Development Agreement ("ARDA")	20	21
Less: Federal government share of ARDA properties	(10)	(10)
Property used by Nova Scotia Agricultural College and Community Pastures	1,058	1,004
	1,479	1,580
Real estate held for sale	4,162	2,508
	5,641	4,088

Real estate held for resale

The assets held for sale, comprising land, buildings and equipment, have been written-down to estimated realizable value. Realizable value was estimated by management, utilizing external appraisals for the land and buildings, based on the expected selling prices, net of estimated closing costs.

Real estate held for resale has been written down from the original loan amounts as follows:

	2011 $	2010 $
Original funds advanced	11,879	9,326
Less: Provision for real estate	(7,717)	(6,818)
Real estate held for sale	4,162	2,508

7 Bad debt expenses

	2011 $	2010 $
Bad debt expenses include:		
Provision for impaired loans	448	4,133
Write-down of real estate held for resale	208	531
	656	4,664

(in thousands of dollars)

8 Advances from the Province of Nova Scotia

Advances are provided by the Province of Nova Scotia to fund loans issued by the Farm Loan Board. Interest expense is calculated in accordance with a Memorandum of Understanding with the Nova Scotia Department of Finance (note 9).

9 Interest expense

Since April 1, 1998, a Memorandum of Understanding ("MOU") between the Board and the Nova Scotia Department of Finance has formalized the Board's funding arrangement. Under the MOU arrangement, the Board estimates projected lending requirements on a quarterly basis. The Nova Scotia Department of Finance arranges the requested financing for terms requested and provides this financing to the Board at interest rates related to the terms and volumes requested. Funding is maintained to cover the Board's investment in loans receivable and in real estate. The Board tracks the draws arranged with the Nova Scotia Department of Finance and computes the interest cost based on the terms of these draws. Actual financing costs are included as interest costs of the Province.

10 Operating expenses

	2011 $	2010 $
Payroll	1,162	1,034
Supplies and services	115	94
Travel	53	50
Professional services/special services	100	69
Training and development	16	11
Equipment and other	31	30
	1,477	1,288

11 Financial instruments and risk management

(i) Fair value of financial instruments

Financial instruments

The carrying value of accrued interest and other accounts receivable approximate their fair value because of their short term-to-maturity.

The Board is exposed to financial risk that arises from the credit quality of the individuals and entities to which it provides loan services. Credit risk arises from the possibility that the individuals and entities to which the Board provides loan services may experience financial difficulty and be unable to fulfill their obligations.

(in thousands of dollars)

11 Financial instruments and risk management (continued)

(i) Fair value of financial instruments (continued)

Financial instruments (continued)

The Board has recorded a provision for potential credit losses after an extensive review of the loan portfolio by management. Due to the number of factors which would affect the fair value of the loan portfolio, including the credit rating of the borrower and the related risk premium, interest rates and valuation of the security; it is not practical to determine the fair value of this financial asset with sufficient reliability.

(ii) Risk management

Credit risk

The risk that clients may not pay amounts owing on loans and lease accounts, resulting in a loss to the Board, is managed through an initial assessment of the client's ability to pay, and by review and follow-up of delinquent accounts by loan officers. In cases in which the client is unable to make payments, due to cyclical industry or other temporary difficulties, it is the Board's policy to work with the client on an individual basis to provide time for recovery.

The total of loans at March 31, 2011 is $160,895 (2010 - $168,186). The majority of loans are secured primarily by real property using mortgage of Agreement of Sale (providing rights similar to a mortgage). Dairy and poultry loans are generally also secured by an irrevocable assignment of production quota. Collateral security may also be provided by equipment, livestock or chattels. It is not practical to determine the maximum exposure to credit risk due to the cost associated in determining the fair value of security and collateral security on unimpaired loans.

All clients are involved in agriculture in Nova Scotia. Involvement in processing is limited to on-farm processing. Regulations provide that loans must not exceed 90% of security value without approval by the Board. Collateral held for security is assigned a value by the loan officer considering the loan based on known transactions of similar property, with additional information provided by property assessments and external assessments, where available.

The Board adjusts the provision for impairment to recognize management's estimate of recoveries on impaired accounts. Impairment is primarily identified by review of arrears, refinanced loans and accounts in sectors experiencing difficulty. A total of $3,695 (2010 - $2,413) was issued in refinanced loans during 2010-2011 to clients with significant arrears.

(in thousands of dollars)

11 Financial instruments and risk management (continued)

(ii) Risk management (continued)

Liquidity risk

The Province of Nova Scotia provides funding and cash management services to the Board. There is no risk that funds will be unavailable to meet lending commitments except to the extent of legislative and budgetary limitations on spending authority as identified in note 1.

Interest rate risk

In order to mitigate the risk that future changes in interest rates may affect net interest revenue, the Board attempts to match terms of loans offered with those of funds drawn through the Province. All loans provide for an optional 10% repayment at any time during each calendar year and an optional full repayment on each 5 year anniversary. All loans are contracted for the full term of their amortization which may range from 1 to 30 years. Funds drawn through the Province provide for 10% annual and 5 year full optional repayments.

Loans receivable (net)

The following schedule sets out the scheduled maturities of the financial assets as at March 31, 2011, together with the weighted average interest rates being earned on the financial assets.

				2011	2010
	Under 1 year $	**1 – 5 years** $	**Over 5 years** $	**Total** $	**Total** $
Farm loans	17,622	67,216	40,158	124,996	119,270
Timber loans	13	51	14	78	325
	17,635	67,267	40,172	125,074	119,595
Average effective annual interest rate	4.96%	4.99%	5.11%		
Add: Principal receivable on impaired loans (excluded from above)				35,821	48,591
Total principal				160,895	168,186
Less: Provision for loan impairment				(7,671)	(15,613)
				153,224	152,573

(in thousands of dollars)

11 Financial instruments and risk management (continued)

(ii) Risk management (continued)

Life insurance risk

The Board requires borrowers to participate in a group life insurance program administered by the Board unless the borrower has arranged alternative life insurance coverage. The net annual gain or loss under contract with the insurance provider (premium revenue less the cost of life insurance claims) to a maximum of $250 on any claim, plus administrative costs, are costs or revenues of the Board and may vary from year to year.

12 Government contributions

Expenses for the year ended March 31, 2011 were paid by the Department of Agriculture on behalf of the Board. Interest expense on funds borrowed to make loans is an expense of the Nova Scotia Department of Finance. Accordingly, these expenses are included in Government Contributions in the Statement of Operations.

13 Related party transactions

The Board is related to all other departments, agencies, boards and commissions of the Province of Nova Scotia. The Nova Scotia Department of Finance is the sole source of funding for loans (see note 1). Property used by the Nova Scotia Agricultural College is property purchased by the Board for college use and will eventually be transferred to another government department. Transactions with other provincial entities were entered into in the normal course of business.

The Province of Nova Scotia pays certain expenses, including salaries and benefits, rent, travel, professional fees and miscellaneous office expenses, on behalf of the Board with no charge to the Board.

14 Pension and post-retirement benefits

All full-time employees of the Board are entitled to receive pension benefits pursuant to the provisions of a pension plan established under the Public Service Superannuation Act. The plan is funded by equal employee and employer contributions. The employer's contributions are included in the Board's operating expenses. The Public Service Superannuation Fund is administered by the Province of Nova Scotia and any unfunded liability, as well as other obligations related to post-retirement benefits, are the responsibility of the Province. It is not anticipated that any such future costs would be allocated to the Board.

15 Commitments

The Board will hold interest rates for ninety days for any client from the date of receipt of a loan application. As of March 31, 2011, the Board has authorized loans of $10.3 million which had not been disbursed.