OFFICE OF THE AUDITOR GENERAL



Report to the House of Assembly on the Audit of the Financial Statements of the Province of Newfoundland and Labrador

For the Year Ended March 31, 2016

Office of the Auditor General
Newfoundland and Labrador



The Auditor General reports to the House of Assembly on significant matters which result from the examinations of Government, its departments and agencies of the Crown. The Auditor General is also the independent auditor of the Province's financial statements and the financial statements of many agencies of the Crown and, as such, expresses an opinion as to the fair presentation of their financial statements.

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The Office of the Auditor General is an integral component of Government accountability.

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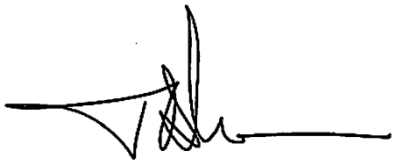
November 8, 2016

The Honourable Tom Osborne, M.H.A.
Speaker
House of Assembly

Dear Sir:

In compliance with the *Auditor General Act*, I have the honour to submit, for transmission to the House of Assembly, my Report on the Audit of the Financial Statements of the Province of Newfoundland and Labrador for the year ended March 31, 2016.

Respectfully submitted,



TERRY PADDON, CPA, CA
Auditor General

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CHAPTER 1
INTRODUCTION

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Introduction

This Report provides information and commentary on the Consolidated Summary Financial Statements (the Public Accounts) of the Province for the year ended March 31, 2016, and comments on the risks and challenges the Province faces also considering the information provided in Budget 2016 and the additional information contained in the Fiscal and Economic Update provided by the Province in October 2016.

As Auditor General, I am responsible for this Report to the House of Assembly.

2015-16 Public Accounts

The Province tabled the Public Accounts on October 19, 2016. The Consolidated Summary Financial Statements for the year ended March 31, 2016, shows a deficit for the year of $2.2 billion, the largest in the Province's history. Net Debt at March 31, 2016 amounts to $12.7 billion, also the largest level in the history of the Province.

Deficits of this magnitude are not sustainable.

The 2015-16 Public Accounts show the continuation of a trend of significantly lower revenue, mostly the result of lower oil royalties due to declines in oil production and price. In 2011-12, oil royalties accounted for almost 34% of provincial revenue. In 2015-16, this has fallen to less than 9%.

The 2015-16 Public Accounts in conjunction with forecast information provided in Budget 2016 and the 2016 Fiscal and Economic Update paint a picture of the Province's finances which suggests corrective action must be taken to ensure a return to a stable financial footing.

2016-17 Outlook

The Province's economic and financial outlook for 2016-17 was provided, initially in Budget 2016, with an update provided in the 2016 Fiscal and Economic Update.

The expected deficit for 2016-17 is now forecast to be approximately $1.5 billion, about $700 million lower than the previous year. Tax measures announced in Budget 2016 have provided a significant boost to revenues. While this is an improvement from the original forecast contained in Budget 2016, it still remains a significant deficit. Relative to other provinces, the expected deficit in Newfoundland and Labrador is forecast to be 10 times greater than the average of all other provinces.

Interest expense was revised upward for 2016-17 by $131 million to an expected total of $1.1 billion for the year – a 13.4% increase from the original estimate. This revised level of interest expense can be expected to carry into subsequent years. This will increase the challenge faced by the Province to return to a balanced budget.

Net debt at March 31, 2017 is now projected to be $14.6 billion which will be a new record high for the Province. Future growth in net debt can only be reversed if the province returns to recording budget surpluses.

The Province released an updated economic forecast in conjunction with the 2016 Fiscal and Economic Update. Most economic indicators have deteriorated in the 6 months since the economic forecast released as part of Budget 2016 – this indicates there may be some risk for the revenue forecast for the remainder of 2016-17 and, also, future years.

Medium Term Outlook - 2017-18 to 2022-23

Budget 2016 outlined the Province's deficit expectations to 2022-23. This forecast shows deficits that are reducing over that period but with a considerable deficit of $436 million still remaining by 2022-23. This deficit forecast is based on an assumption of increasing oil prices over the period to eventually reach $US74 per barrel and substantial increases in oil production. This is in combination with the tax measures announced in the budget. Achieving the forecast is dependent on achieving the assumptions which are the foundation of the forecast. There is considerable risk that changing circumstances over the six year period could negatively impact the outlook.

Budget 2016 also laid out deficit targets for the period to 2022-23. The Province indicated it intends to take action to achieve a balanced budget by 2021-22 and a return to surplus by 2022-23. The projected deficit in 2022-23 will have to be reduced by in excess of $500 million in order to achieve the target. The 2016 Fiscal and Economic Update released in October 2016 did not provide any update to the medium term forecast or the targets. The specific actions intended to achieve the target of a return to surplus have not been announced.

The Province's economic forecast released as part of the 2016 Fiscal and Economic Update provides information to 2020. Nominal GDP is forecast to show modest growth over the period, largely the result of forecast increases in oil prices and production from the Hebron oil development. Most other economic indicators show significant declines from 2016 to 2020, in particular:

- Retail Sales - 5% decline
- Capital Investment - 37% decline
- Housing Starts - 35% decline
- Employment - 13% decline

This weakness in economic fundamentals will challenge the Province to achieve its revenue forecast over the period and ultimately return to surplus as planned.

A plan to return to surplus is in the best interests of the Province. The absence of actions to achieve the plan will likely result in additional negative pressure on the Province's credit ratings and, ultimately, on the cost of borrowing. Access to capital markets may also become impaired.

Lower Churchill Project

On December 17, 2012, Government announced the sanction of the Lower Churchill Project (the Project). The Project consists of an 824 megawatt hydroelectric plant, a transmission line connecting the Muskrat Falls plant to the Churchill Falls plant and a transmission line to move the power from the Muskrat Falls hydroelectric plant to the island part of Newfoundland and Labrador.

The Project is currently expected to cost $11.4 billion, including interest during construction/pre-funded financing costs of $2.3 billion. This represents an increase of $4.0 billion from the expected cost when it was sanctioned. As of September 30, 2016, Nalcor Energy and/or its subsidiaries had spent $6.1 billion related to the Project and had contractual commitments to spend a further $2.4 billion.

A portion of the Project has been financed through an issuance of bonds by Nalcor Energy project subsidiaries in the amount of $5.0 billion. The bonds are fully guaranteed by the Government of Canada. The Province has also provided a guarantee to the Government of Canada to compensate it for any costs under this Guarantee which are triggered by legislative or regulatory actions of the Province. The remaining cost of $6.4 billion was expected to be financed through equity contributions from the Province and Nalcor Energy, as well as Emera, which has a minority partnership interest in the Labrador-Island Link. On November 3, 2016, the Province announced that it has secured a commitment from the Government of Canada to provide up to an additional $2.9 billion in loan guarantee support for the Project.

The Province has also committed to funding all additional equity which may be required to cover any further cost overruns on each aspect of the Project. Nalcor Energy and the Province will have to ensure sufficient risk mitigation strategies are put in place to limit the exposure of taxpayers to increased costs to complete the Project.

During 2012-13, the Lower Churchill Project Regulatory Regime was adopted by the Province. This regulatory regime allows costs, expenses or allowances related to the Project to be recovered in full from the ratepayers in the Province. Such expenditures will not be subject to review by the Public Utilities Board.

The business model for the Project included an expectation that the taxpayers of Newfoundland and Labrador would recover the equity used to finance the Project plus a return on that equity. The recovery of equity and any potential return will be dependent on the electricity rates imposed on ratepayers after the Project comes into service. Higher electricity rates result in a higher return for taxpayers on their investment in the Project. Lower rates will result in a lower return for taxpayers but would benefit ratepayers. The Province and Nalcor Energy will have to balance the competing interests of taxpayers and ratepayers as they determine an appropriate electricity rate structure in Newfoundland and Labrador.

Reports issued pursuant to Section 15(1) of the *Auditor General Act*

Section 15(1) of the *Auditor General Act* (the *Act*) requires the Auditor General to report to the Lieutenant-Governor in Council instances the Auditor General becomes aware of during the course of an audit which may involve improper retention or misappropriation of public money or another activity that may constitute an offence under the Criminal Code or another Act. Section 31 of the *Act* requires the report be made through the Minister of Finance. In addition, Section 15(2) of the *Act* requires that I attach to my annual report a list containing a general description of the incidents and the date reported to the Lieutenant-Governor in Council.

During the audit of the Public Accounts for the year ended March 31, 2016, my Office became aware of the following matters, all of which I reported to the Minister of Finance on October 14, 2016:

- The Professional Services and Internal Audit Division (the Division) of the Department of Finance informed my Office that the Office of the Comptroller General was notified of alleged fraud at the Newfoundland and Labrador English School District. The Division investigated the matter. While the Division's investigation was occurring, the Lieutenant-Governor in Council requested that my Office investigate the matter. My Office is currently undertaking its investigation.

- The former Department of Seniors, Wellness and Social Development informed my Office of two instances involving the theft of cash. On two separate occasions during April and May 2016 an illegal entry occurred at the Labrador Training Centre in Happy Valley-Goose Bay. The total theft from both instances was approximately $540. Both instances were reported to the police for investigation.

- The former Department of Advanced Education and Skills informed my Office of one instance of alleged client fraud. An individual is alleged to have received Income Support while also receiving employment income. The matter was investigated by the Department's Eligibility Assurance Unit and forwarded to the police for additional investigation. The individual was subsequently charged with fraud over $5,000.

- The former Forest and Agrifoods Agency informed my Office of one instance of alleged fraud involving an employee who was utilizing a corporate charge card for personal purchases. The purchases totaled $14,000 and occurred over a 90 day period. The Agency is not liable for the charges and the financial institution providing the charge card is reported to be seeking repayment from the employee. The Agency reports that the employee was disciplined and that the matter was not referred to the police.

- The Department of Transportation and Works informed my Office of the following alleged frauds:

    - An employee admitted to use of a Government fuel credit card to buy personal items totaling approximately $200-$300. The fraud was reported to, and investigated by, the Strategic Human Resources Management Unit (SHRM Unit) of the Human Resources Secretariat resulting in the eventual termination of the employee. The incident has been reported to the police for investigation.

    - During the period from November 2015 to April 2016, an employee is alleged to have used a Government fuel credit card to purchase items for personal use. The suspected fraud was reported to the Department's management by the supplier. The Department referred the allegation to the SHRM Unit for investigation. The internal investigation is ongoing.

    - During February 2016, tires were reported missing by an employee of one of the Department's depots. This incident was reported to the Department's Security Division and the police. The SHRM Unit was made aware of this incident and they determined there was insufficient information to conduct an investigation.

    - During January 2016, there was a report of possible salt and fuel theft from one of the Department's depots. The incident has been reported to management, the Department's Security Division and the SHRM Unit and is still under investigation.

    - An investigation involving suspected fraud is currently ongoing which involves several employees of the Department. The suspected fraud occurred in April and June 2016. The SHRM Unit is presently conducting an investigation. The department informed my Office that, to date, one employee has been terminated.

As part of the audit of the Public Accounts for the year ended March 31, 2016, my Office reviewed the audit working papers of significant Crown entities for which I am not the auditor. As a result of this review, my Office became aware of the following instances of alleged fraud or other activities that may constitute an offence under the Criminal Code or another Act, which I reported to the Minister of Finance on October 14, 2016:

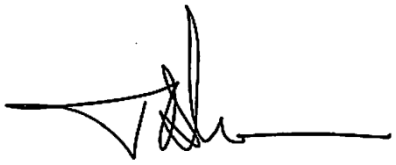
- The Newfoundland and Labrador English School District reported a theft of cash. It was alleged that during 2014 a theft occurred by an employee of a contractor undertaking repairs at a school. The theft was reported to both the contractor and the police. The individual was subsequently charged.

- The Eastern Regional Health Authority reported a theft of cash. During the period of December 2014 to May 2015, an employee is alleged to have misappropriated cash receipts that were intended for the trust accounts of patients. The employee was terminated and the matter was reported to the police for investigation.

During the our audit of the financial statements of the Support Enforcement Division of the Department of Justice and Public Safety (Support Enforcement), my Office became aware of a possible fraud. On two instances a cheque which was potentially fraudulent cleared Support Enforcement's bank. Officials at Support Enforcement became aware of the two transactions and contacted its bank. It was determined that a valid cheque in the amount of $68 which cleared Support Enforcement's bank in March 2016 was obtained and subsequently re-deposited on two separate occasions using a mobile banking application. The bank reimbursed Support Enforcement $136. Support Enforcement is currently conducting its own internal investigation. I reported this matter to the Minister of Finance on November 2, 2016.

Acknowledgements

I acknowledge the cooperation and assistance my Office has received from the Office of the Comptroller General during the completion of the audit, as well as from officials of the various Government departments and Crown agencies. I also thank the entire staff of the Office of the Auditor General for their hard work, professionalism and dedication.



TERRY PADDON, CPA, CA
Auditor General

CHAPTER 2

SUMMARY OF OBSERVATIONS

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The following is a summary of the observations related to the financial condition of the Province of Newfoundland and Labrador which are contained in Chapter 3 of this Report.

Consolidated Summary Financial Statements

1. The Consolidated Summary Financial Statements must be read in conjunction with forward looking financial information released by the Province and other publically available information in order to gain a more comprehensive understanding of the Province's current financial circumstances and future direction.

Overview

2. From 2007-08 to 2014-15, oil royalties accounted for, on average, 29% of revenues, excluding Atlantic Accord revenues. By 2015-16 this had dropped to 9% and for 2016-17 the Province is projecting that oil royalties will still only comprise 9% of government revenue.

Economic Outlook

Gross Domestic Product

3. The Province's economic forecast is based on assumptions and future expectations and, like any forecast, is subject to considerable risk and change. Given that the economic forecast provides the basis for predicting taxation and other provincial revenues, this risk also extends to the Province's revenue forecast.

4. Nominal GDP is forecast by the Province to steadily increase from 2016 to 2020 based on increases in oil production and prices.

5. The expected financial results, based on the current economic forecast, will not be sufficient to eliminate the Province's expected deficits in the near term.

Capital Investment

6. Large capital and labour intensive construction projects generate strong levels of employment and considerable benefits throughout the economy and to the treasury, but these benefits are time limited to the construction cycle.

7. Capital investment is expected to decline significantly from 2016 through 2020 which will have a corresponding negative impact on employment and revenue to the treasury.

Employment

8. Employment is forecast to decline by 31,100 persons from 2016 through 2020, a 13% reduction.

9. The forecast decline in employment will negatively impact personal income tax revenue and will also impact retail sales with an associated negative impact on HST revenue and other consumption taxes such as gasoline tax.

Deficits

2015-16

10. The deficit recorded by the Province for the year ended March 31, 2016, was $2.2 billion - more than 2 times greater than the deficit recorded in the previous year and a $1.1 billion deterioration from the amount predicted in Budget 2015.

11. The deficit of $2.2 billion recorded in 2015-16 is the highest ever recorded by the Province.

12. The Province has accumulated deficits in excess of $3.8 billion over the last four fiscal years.

Projected Deficits 2016-17 to 2022-23

2016-17

13. The Province is now expecting a deficit of $1.5 billion for 2016-17. The improvement in the forecasted deficit is the result of a combination of higher oil revenues and lower program expenses. These were offset by a 13.4% increase in debt servicing expenses.

2016-17 to 2022-23

14. Projected deficits for the years 2016-17 to 2022-23 are now forecast to total $5.8 billion.

15. Given that the current forecast is based on an assumption of steadily increasing oil prices up to 2022-23, there is risk that the forecast revenue growth may not be achieved.

16. Program expenses are forecast to grow by $197 million over the same seven year period – an increase of 2.7% or an average of 0.4% per year.

Deficit targets

17. The Province indicates that it will initiate policy action to eliminate the deficit by 2021-22. This policy action could be a combination of additional revenue raising measures or expenditure reductions.

Deficit as a percentage of GDP

18. Newfoundland and Labrador's deficit as a percentage of GDP for 2015-16 is 7.4% - almost four times greater than the next highest province.

19. The forecast deficit as a percentage of GDP for 2016-17 is expected to be 5.1% - approximately 1½ times greater than the next highest province.

2016-17 to 2020-21

20. Throughout the forecast period, the Province is facing deficits that, in relation to the size of the economy, will be up to 10 times higher than the average of all the other provinces and reducing to four times higher by 2020-21, still well beyond what would be considered reasonable and sustainable.

21. In the absence of further Government policy action, the Province is expecting substantial deficits to persist until 2022-23 and, likely, beyond.

22. Dealing with the anticipated deficits the Province is forecasting over the next number of years will require hard choices that will affect all Newfoundlanders and Labradorians

Net Debt

2015-16

23. Net Debt of the Province at March 31, 2016, was $12.6 billion, an increase of $2.3 billion from the previous year and the highest level in Province's history.

24. At March 31, 2016, Net Debt had increased by approximately $4.8 billion from its low point in 2011-12, primarily the result of deficits totaling $3.8 billion in the 2012-13 through 2015-16 fiscal years plus the impact of tangible capital asset acquisitions during this period.

Tangible Capital Assets (Infrastructure)

25. While the Province reduced infrastructure spending by $128 million during 2016, the Province's annual spending on infrastructure has averaged $518 million from 2013 through 2016 - approximately double the spending that occurred from 2007 through 2009.

26. Any initiative designed to reduce the deficit and, by extension, control the growth in Net Debt will have to consider the appropriate level of spending on new infrastructure in the Province.

2016-17 to 2022-23

27. The Province's Net Debt is forecast to increase to $14.6 billion by March 31, 2017, the highest level of Net Debt in the Province's history.

28. Deficits, totaling almost $5.8 billion, combined with spending on infrastructure from 2016-17 to 2022-23 are expected to increase Net Debt.

29. Over the period 2016-17 to 2022-23, the Province expects to borrow $8.0 billion in the capital markets to:

- Re-finance existing debt as it comes due.
- Satisfy commitments under the promissory notes issued as part of the pension reform process.
- Finance deficits and infrastructure spending.
- Fund the Province's currently expected share of equity for the Muskrat Falls project. Any additional cost overruns on the Muskrat Falls project would require additional equity and borrowings by the Province.

Net Debt Per Capita

30. By March 31, 2017, Net Debt per capita is expected to reach $27,542. This level is the highest in the Province's history and would represent a significant financial burden for each and every Newfoundlander and Labradorian.

Net Debt as a Percentage of GDP

31. Net Debt as a percentage of GDP is forecast, by the Province, to increase to 49.5% at March 31, 2017. The expectation of continued deficits beyond 2016-17 will continue to increase the ratio of Net Debt to GDP in the future.

Revenues

32. For the year ended March 31, 2016, total revenue was $2.3 billion below the peak achieved in 2011-12.

33. For 2016-17, oil royalties are forecast to be $601 million, well below the $2.8 billion recorded in 2011-12.

34. The Province is forecasting revenue to grow by $2.2 billion over the seven year period to 2022-23. This growth in revenue is dependent on the Province achieving the economic growth and the levels of oil production and oil price forecast in Budget 2016. Considerable risk surrounds the Province being able to achieve these targets.

Oil Royalties

35. Oil royalties in 2015-16 were $515 million, a drop of $2.3 billion from the peak of $2.8 billion in 2011-12.

36. In 2016-17, oil royalties are expected to account for just 8.6% of revenue, a significant drop in five years from the peak of 33.8% in 2011-12.

Oil Production

37. Annual production of offshore oil has shown a downward trend since 2007-08, but is expected to increase with the commencement of production from the Hebron field.

2016-17

38. From April to August 2016, average actual monthly production has exceeded the average forecasted monthly production; however, actual monthly production has varied considerably. There is still risk that the production forecast may not be achieved

Oil Price

2015-16

39. The average annual price of Brent Crude peaked in 2011-12 at $US114.65 per barrel and has been steadily declining since that time. In 2015-16, the price of Brent crude averaged $US47.30 per barrel.

2016-17

40. Forecasting the price of oil involves risk. During 2016-17 to date, the actual average price of Brent crude has exceeded the forecasted average price.

2017-18 to 2022-23

41. The Province is forecasting the price of Brent crude to average $US52 in 2017-18 and expects to see steady annual increases to $US74 per barrel by 2022-23. This increase in Brent crude will not be enough, on its own, to address the fiscal challenges being faced by the Province.

Expenses

42. Total expenses have grown from $5.4 billion in 2006-07 to $8.2 billion in 2015-16, an increase of $2.8 billion or 52%.

Program Expenses

2006-07 to 2015-16

43. Program expenses have grown by 56.9% over the ten year period from 2006-07 to 2015-16.

2016-17 to 2022-23

44. Program expenses are forecast to increase by approximately $197 million between 2015-16 and 2022-23, an average growth rate of only 0.4%. This level of expense increase is less than the expected rate of inflation and would not allow for inflationary or other pressures.

45. A $436 million deficit is still anticipated in 2022-23 despite a forecast of modest expense growth.

Program Expenses by Department

46. Almost 72% of program expenses are directed to the health, education and skills development sectors.

Program Expenses by Category

47. In 2015-16, the Province spent $3.5 billion on salaries and employee benefits which represents 49% of the total program spending of Government.

Deficit Reduction Targets

48. Given that 72% of program expenses are directed towards health, education and skills development and 49% of program expenses are on salaries and benefits, any measures to reduce expenses in a substantive way, will, by necessity, have to focus on these areas.

Interest costs

49. The Fiscal and Economic Update indicates an expected increase of $132 million in interest costs in 2016-17 beyond what was forecast in Budget 2016. It can be expected that this increase will follow in each year of 2017-18 to 2022-23, with the potential to add at least $1.0 billion to cumulative interest costs and deficits over that period.

50. Money allocated to servicing debt is money that is not available to fund programs and services.

51. By 2016-17, approximately 15.9 % of every dollar of revenue generated is forecast to be allocated to interest expense.

CHAPTER 3

THE FINANCIAL CONDITION OF THE PROVINCE

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Consolidated Summary Financial Statements

The Consolidated Summary Financial Statements (the Public Accounts) reflect the financial position and annual operating results of all organizations in the Government Reporting Entity (GRE). They combine the financial position and operating results of central Government, the Legislature and departments, with those of all other Government entities.

The Consolidated Summary Financial Statements provide the most complete information about the financial position and operating results of the Province and are an important document which enables the House of Assembly, and Newfoundlanders and Labradorians, to hold Government accountable for its stewardship of public funds.

The Consolidated Summary Financial Statements provide information as at March 31, 2016, on the Province's financial condition and the results of its financial performance for the year then ended. Given the current commodity price slump, these financial statements must also be viewed in the context of future expectations in order to get a more comprehensive picture of the financial condition of the Province.

Observation

1. The Consolidated Summary Financial Statements must be read in conjunction with forward looking financial information released by the Province and other publically available information in order to gain a more comprehensive understanding of the Province's current financial circumstances and future direction.

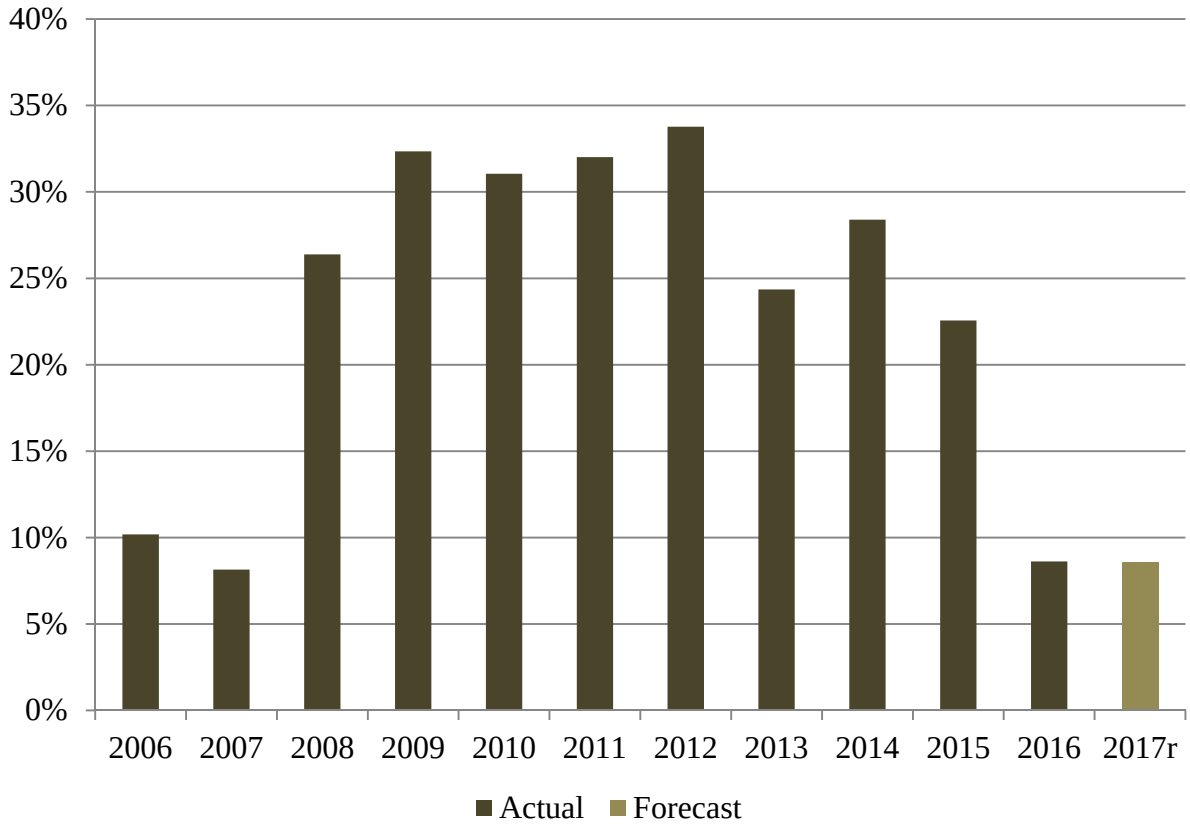
Overview

The continued decline in commodity prices, and in particular crude oil, has had a significant impact on the financial outlook of the Province of Newfoundland and Labrador.

From 2008 to 2015, the price of Brent crude averaged approximately $US92 per barrel. In 2016, Brent crude had declined to an average of $US47 per barrel. From April 2016 to September 2016, Brent crude further declined to an average of $US46 per barrel. The consequence of such a dramatic and sustained reduction in oil prices has been a corresponding impact on the finances of the Province. From 2007-08 to 2014-15, oil royalties accounted for, on average, 29% of revenues, excluding Atlantic Accord revenues. By 2015-16 this had dropped to 9% and for 2016-17 the Province is projecting that oil royalties will still only comprise 9% of government revenue.

Chart 1

Province of Newfoundland and Labrador
Oil royalties as a percentage of total revenue
Years ended March 31



Note: Total revenue excludes revenues received under the Atlantic Accords.
Source: Public Accounts (actual); Department of Finance (forecast)

Observation

2. From 2007-08 to 2014-15, oil royalties accounted for, on average, 29% of revenues, excluding Atlantic Accord revenues. By 2015-16 this had dropped to 9% and for 2016-17 the Province is projecting that oil royalties will still only comprise 9% of government revenue.

This chapter provides an assessment of the financial condition of the Province using historical information drawn from the Public Accounts, as well as forecasted financial information for 2016-17 to 2022-23 obtained from Budget 2016, the October 2016 Fiscal and Economic Update and other publically available information. Any references to forecasted surpluses or deficits exclude the Revenue Risk Adjustment which was included by the Province in the forecast.

Economic Outlook

The economic forecast is the foundation for budget making. It provides a view forward which should be based on reasonable and realistic assumptions regarding future expectations.

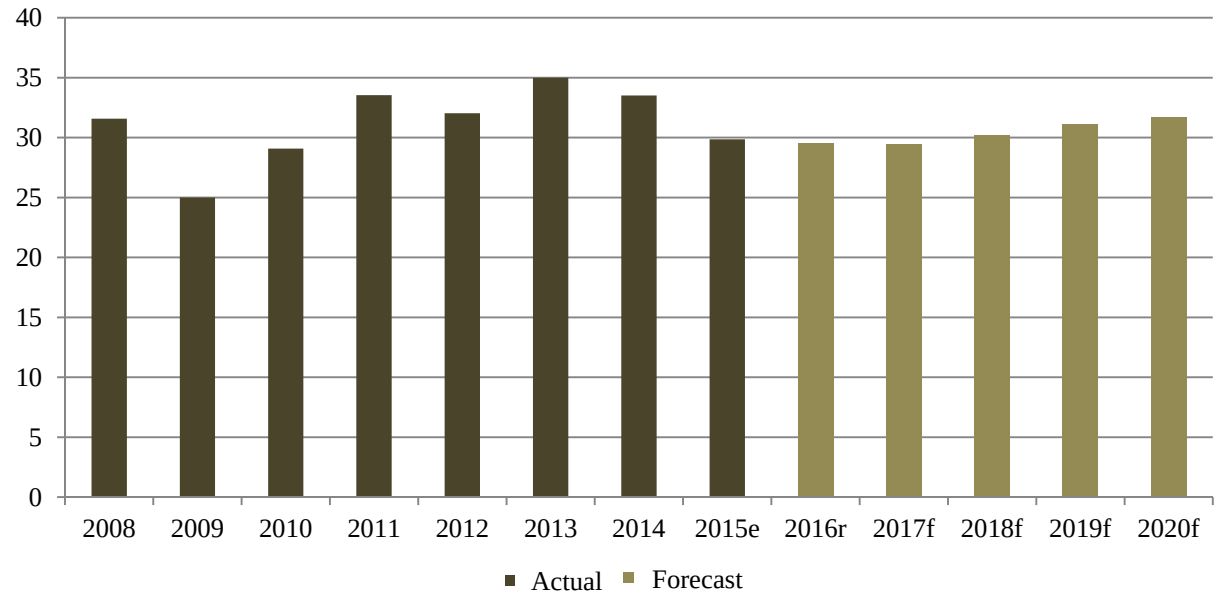
Gross Domestic Product

Gross domestic product (GDP) is the measure of the value of goods and services produced by the economy. GDP can be expressed in either nominal or real terms. Nominal GDP values the goods and services at today's prices while real GDP excludes the impact of changing prices on the value. Nominal GDP could be considered an economic proxy for the base on which government revenue is generated and an appropriate indicator to use to examine the potential for government revenue generation in the future.

The Province's economic forecast is based on assumptions and future expectations and, like any forecast, is subject to considerable risk and change. Given that the economic forecast provides the basis for predicting taxation and other provincial revenues, this risk also extends to the Province's revenue forecast.

Chart 2

Province of Newfoundland and Labrador
Nominal GDP
($ Billions)



Source: Department of Finance

Nominal GDP has experienced considerable fluctuation and volatility since 2008. Most notably, during the recession of 2009 GDP was primarily impacted by declines in commodity prices, and in 2016, when GDP is being impacted by both price and oil production declines.

The Province's economic forecast for 2016 to 2020 indicates steady GDP growth, driven by anticipated increases in oil prices and oil production.

Much of the increased oil production is expected from the development of the Hebron field. Because of the structure of the royalty regime, it would not be expected that royalty revenue would increase in proportion to the increase in production. Royalty rates increase as cumulative profitability increases which is impacted by oil prices and time. The heavier nature of Hebron crude will also have a dampening impact on the oil price received for the production from this development.

The expected financial results, based on the current economic forecast, will not be sufficient to eliminate the Province's expected deficits in the near term.

Observations

3. The Province's economic forecast is based on assumptions and future expectations and, like any forecast, is subject to considerable risk and change. Given that the economic forecast provides the basis for predicting taxation and other provincial revenues, this risk also extends to the Province's revenue forecast.

4. Nominal GDP is forecast by the Province to steadily increase from 2016 to 2020 based on increases in oil production and prices.

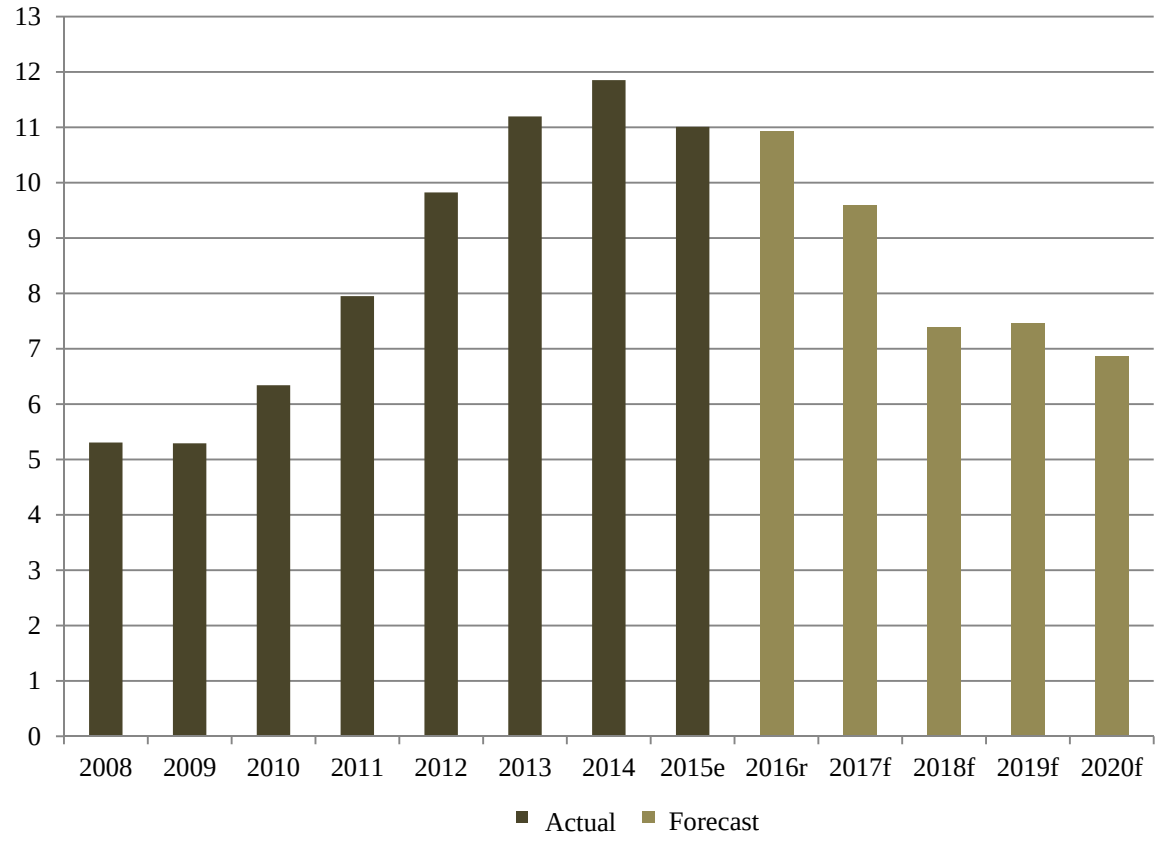
5. The expected financial results, based on the current economic forecast, will not be sufficient to eliminate the Province's expected deficits in the near term.

Capital Investment

The Newfoundland and Labrador economy is primarily resource based and activity in recent years has been dominated by large, capital and labour intensive projects, such as construction of the Long Harbour nickel processing facility and development of the Hebron oil field and Muskrat Falls. These projects generate strong levels of employment and considerable benefits throughout the economy and to the treasury, but these benefits are time limited to the construction cycle.

Chart 3

Province of Newfoundland and Labrador
Capital Investment
($ Billions)



Source: Department of Finance

The Province is forecasting significant declines in the level of capital investment from 2016 through 2020 as the construction phases of the Hebron and Muskrat Falls developments come to a conclusion. The potential of further provincial deficit reduction measures could also impact the level of capital investment in the Province. This decline in activity will have a corresponding drop in employment and will negatively impact revenue to the treasury from tax sources such as personal income tax and consumption taxes such as the HST.

Observations

6. Large capital and labour intensive construction projects generate strong levels of employment and considerable benefits throughout the economy and to the treasury, but these benefits are time limited to the construction cycle.

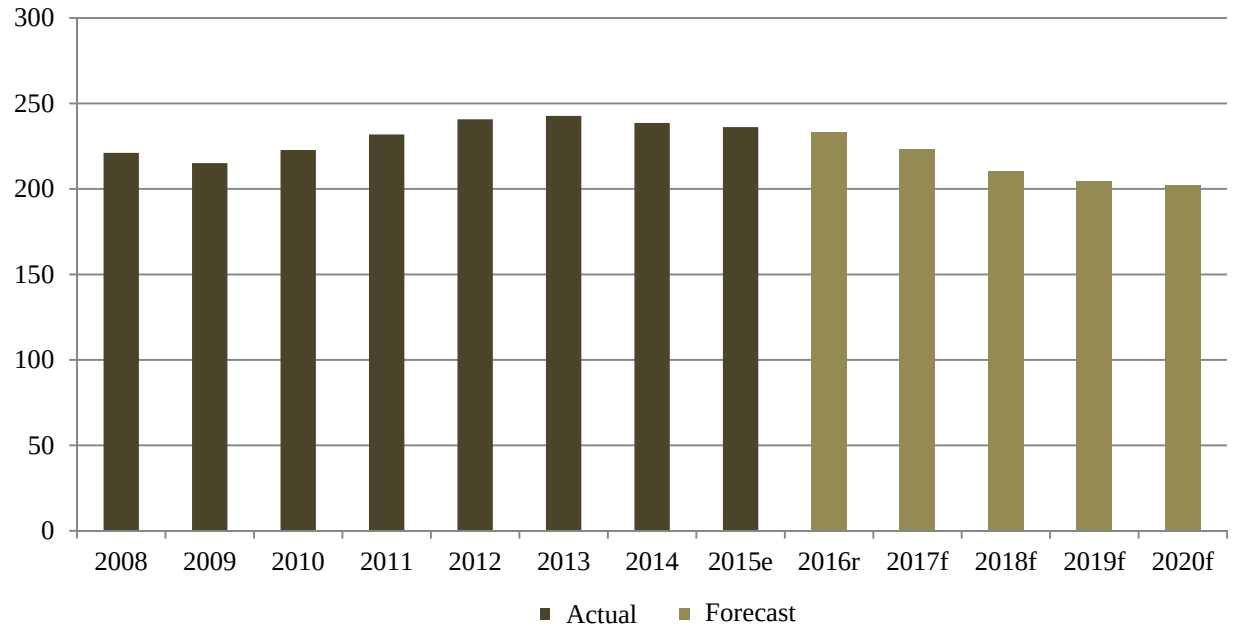
7. Capital investment is expected to decline significantly from 2016 through 2020 which will have a corresponding negative impact on employment and revenue to the treasury.

Employment

Consistent with the decline in capital investment, the Province is also forecasting a significant decline in employment levels from 2016 through 2020. This will negatively impact personal income tax revenue and will also impact retail sales with an associated negative impact on HST revenue and other consumption taxes such as gasoline tax.

Chart 4

Province of Newfoundland and Labrador
Employment
(Thousands)



Source: Department of Finance

By 2020, the Province is forecasting employment to drop from the expected 233,200 persons in 2016 to 202,100 persons by 2020. This is a decrease of 31,100 persons over a four year period - 13% of the workforce.

Observations

8. Employment is forecast to decline by 31,100 persons from 2016 through 2020, a 13% reduction.

9. The forecast decline in employment will negatively impact personal income tax revenue and will also impact retail sales with an associated negative impact on HST revenue and other consumption taxes such as gasoline tax.

Deficits

A deficit occurs when the annual level of expenses exceeds the amount of revenue available in the same year. The Province has incurred annual deficits since 2012-13 and is predicting that significant deficits will persist in the foreseeable future.

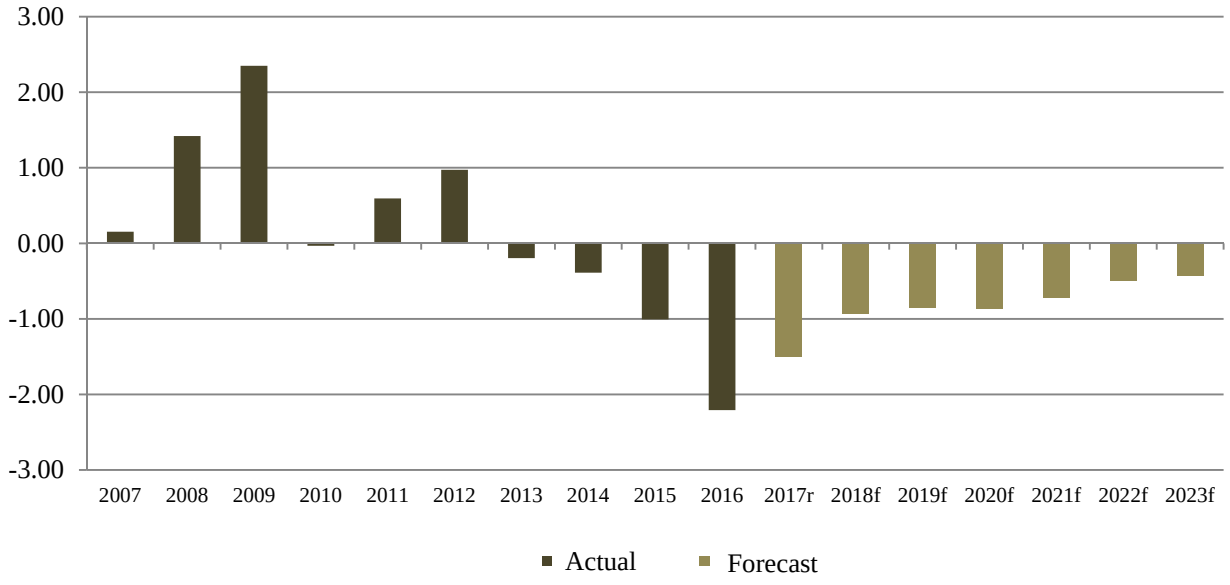
2015-16

For the year ended March 31, 2016, the Province recorded a deficit of $2.2 billion. This is a $1.1 billion deterioration from the amount predicted in Budget 2015.

The Province has recorded deficits in the past four consecutive years. The cumulative total of those deficits for these four years exceeds $3.8 billion. The deficit of $2.2 billion recorded in 2015-16 is over twice the deficit recorded in 2014-15 and is the highest deficit ever recorded in Newfoundland and Labrador.

Chart 5

Province of Newfoundland and Labrador
Surplus/(Deficit)
Years ended March 31
($ Billions)



Source: Public Accounts (actual); Department of Finance (forecast)

Observations

10. The deficit recorded by the Province for the year ended March 31, 2016, was $2.2 billion - more than 2 times greater than the deficit recorded in the previous year and a $1.1 billion deterioration from the amount predicted in Budget 2015.

11. The deficit of $2.2 billion recorded in 2015-16 is the highest ever recorded by the Province.

12. The Province has accumulated deficits in excess of $3.8 billion over the last four fiscal years.

Projected Deficits 2016-17 to 2022-23

The Fiscal and Economic Update released by the Province in October 2016 provided an update on the expected financial results for 2016-17. Budget 2016 provided an estimate of projected deficits to 2022-23 if no action is taken to address these potential outcomes. The October 2016 Fiscal and Economic Update did not provide an update to these medium term deficit projections.

2016-17

Budget 2016 originally forecast a deficit of $1.7 billion for 2016-17. The Province is now expecting a deficit of $1.5 billion for 2016-17. The improvement in the forecasted deficit is the result of a combination of higher oil revenues and lower program expenses. These were offset by a 13.4% increase in debt servicing expenses. There is still considerable weakness in the commodity markets.

Observation

13. The Province is now expecting a deficit of $1.5 billion for 2016-17. The improvement in the forecasted deficit is the result of a combination of higher oil revenues and lower program expenses. These were offset by a 13.4% increase in debt servicing expenses.

2016-17 to 2022-23

In the absence of any intervention, the Province is forecasting significant deficits in each of the next seven years. Projected deficits for the years 2016-17 to 2022-23 are now forecast to total $5.8 billion.

Revenue is forecast to increase over the period by approximately $2.2 billion, an increase of 38% - an average of 5.4% per year. The current forecast is based on an assumption of steadily increasing oil prices to 2022-23. There is risk that the forecast revenue growth may not be achieved.

Program expenses are forecast to grow by $197 million over the same seven year period – an increase of 2.7% or an average of 0.4% per year.

Observations

14. Projected deficits for the years 2016-17 to 2022-23 are now forecast to total $5.8 billion.

15. Given that the current forecast is based on an assumption of steadily increasing oil prices up to 2022-23, there is risk that the forecast revenue growth may not be achieved.

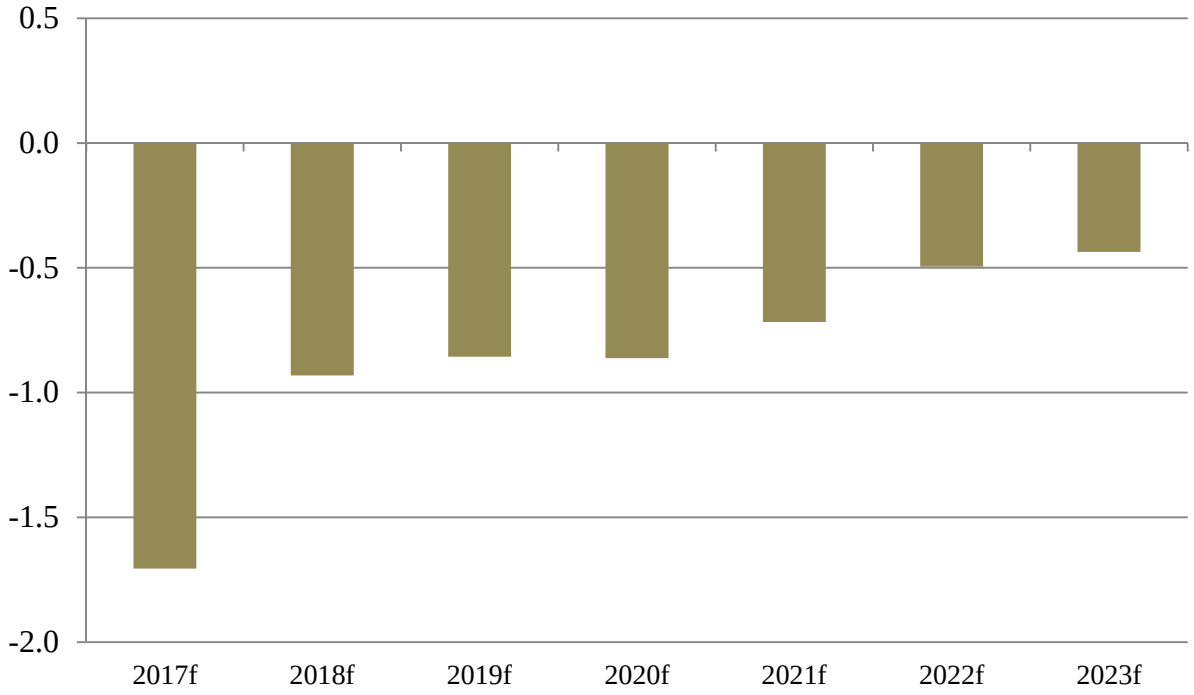
16. Program expenses are forecast to grow by $197 million over the same seven year period – an increase of 2.7% or an average of 0.4% per year.

Deficit targets

Budget 2016 outlined the Province's forecasted deficits from 2016-17 to 2022-23.

Chart 6

Province of Newfoundland and Labrador
Forecasted Deficits
Years ended March 31
($ Billions)



Source: Department of Finance

The Province indicates that it will initiate policy action to eliminate the deficit by 2021-22. This policy action could be a combination of additional revenue raising measures or expenditure reductions.

Observation

17. The Province indicates that it will initiate policy action to eliminate the deficit by 2021-22. This policy action could be a combination of additional revenue raising measures or expenditure reductions.

Deficit as a percentage of GDP

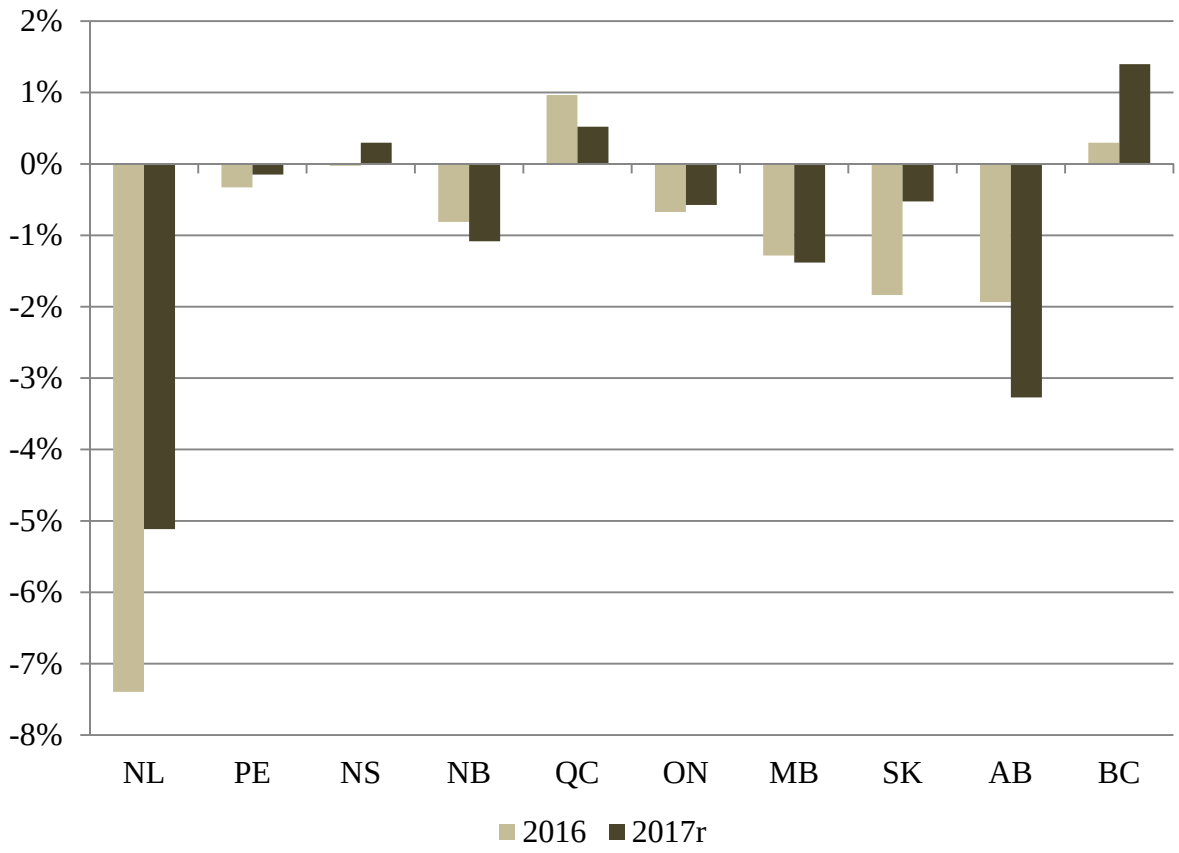
While the absolute amount of the deficit is an important indicator of financial performance, an additional, and more informative, indicator is to express the deficit as a percentage of GDP. This relates the deficit to the size of the Province's economy and provides a basis for comparison of financial performance among other provincial jurisdictions.

2015-16 and 2016-17

Eight provinces recorded deficits for 2015-16 and seven are forecasting deficits for 2016-17.

Chart 7

Provincial Comparison
Deficit as a percentage of GDP
Years ended March 31, 2016 and 2017



Source: Economic Updates - all provinces; Statistics Canada; Public Accounts - all provinces

Newfoundland and Labrador's deficit as a percentage of GDP for 2015-16, at 7.4 %, is almost four times greater than the next highest province, Alberta. The forecast deficit as a percentage of GDP for 2016-17 is expected to be 5.1% and is approximately 1½ times greater than the next highest province, Alberta.

Observations

18. Newfoundland and Labrador's deficit as a percentage of GDP for 2015-16 is 7.4% - almost four times greater than the next highest province.

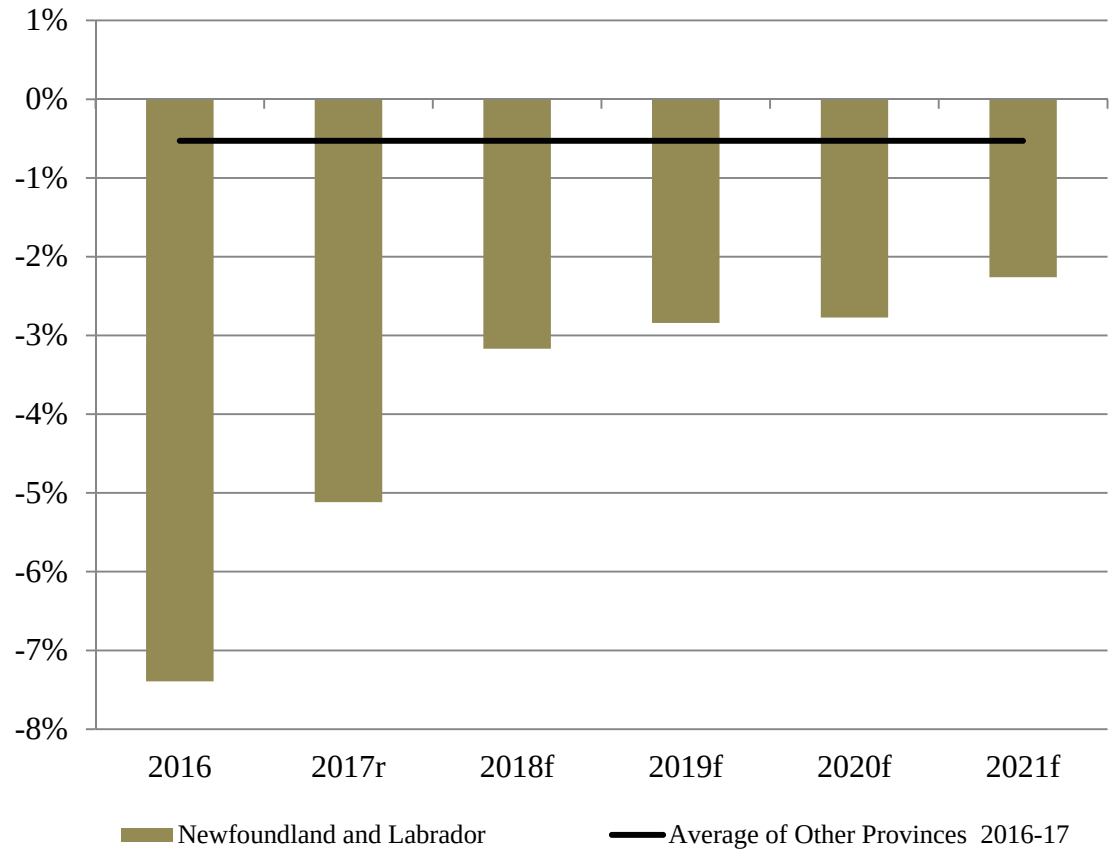
19. The forecast deficit as a percentage of GDP for 2016-17 is expected to be 5.1% - approximately 1½ times greater than the next highest province.

2016-17 to 2020-21

The magnitude of the deficits forecast until 2020-21 means that the Province's relative deficit position will remain at an elevated level over that period. While the Province is predicting some growth in GDP over the period, the Province's deficit to GDP ratio will still be significantly higher than the average of other provinces. Considerable risk exists that the expected GDP growth could be less than forecast and the deficit could be higher than predicted.

Chart 8

Province of Newfoundland and Labrador
Deficit as a percentage of GDP
Years ended March 31



Source: Economic Updates - all provinces; Statistics Canada; Public Accounts - all provinces

Throughout the forecast period, the Province is facing deficits that, in relation to the size of the economy, will be up to 10 times higher than the average of all the other provinces and reducing to four times higher by 2020-21, still well beyond what would be considered reasonable and sustainable.

Observation

20. Throughout the forecast period, the Province is facing deficits that, in relation to the size of the economy, will be up to 10 times higher than the average of all the other provinces and reducing to four times higher by 2020-21, still well beyond what would be considered reasonable and sustainable.

Given the substantial deficits the Province is facing over the next number of years, significant action will be required to reduce these expected deficits and ensure a manageable bottom line. This will require hard choices that will affect all Newfoundlanders and Labradorians.

Observations

21. In the absence of further Government policy action, the Province is expecting substantial deficits to persist until 2022-23 and, likely, beyond.

22. Dealing with the anticipated deficits the Province is forecasting over the next number of years will require hard choices that will affect all Newfoundlanders and Labradorians.

Net Debt

Net Debt represents all the liabilities of the Province less its financial assets and is a standardized, comprehensive, measure of a key element of the Province's financial position. Net Debt is one of the most commonly used indicators to measure the financial health of the Province.

Liabilities are amounts that the Province owes others and include those items which are payable for items purchased in the ordinary course of doing business, amounts borrowed and which will be repaid over a longer time frame and obligations related to employee post-retirement benefits. These benefits include pensions and group health and life insurance.

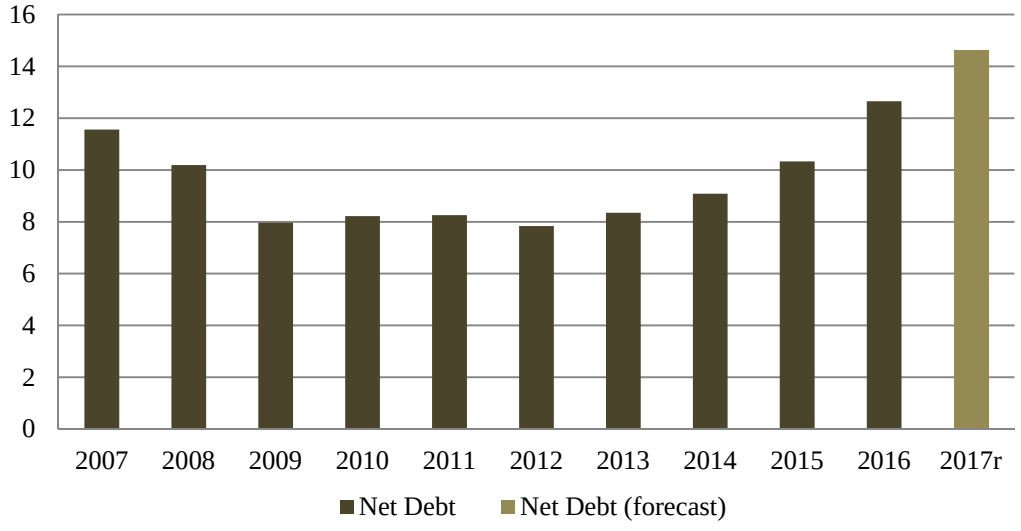
Financial assets are amounts that the Province has available to pay its liabilities or finance future operations. Financial assets consist of cash and temporary investments, amounts receivable from third parties, investments, inventories held for resale and equity in government business enterprises (GBEs) and partnerships. The GBEs of the Province of Newfoundland and Labrador are Nalcor and its subsidiaries and the Newfoundland and Labrador Liquor Corporation. The Province's only Government Business Partnership is its 25% equity interest in the Atlantic Lottery Corporation. GBEs generate revenue for the Provincial treasury through the sale of goods and services.

2015-16

Net Debt of the Province at March 31, 2016 was $12.7 billion, an increase of $2.3 billion from the previous year and the highest level in the Province's history.

Chart 9

Province of Newfoundland and Labrador
Net Debt
Years ended March 31
($ Billions)



Source: Public Accounts (actual); Department of Finance (forecast)

Net Debt is impacted by annual surpluses or deficits and the purchase of tangible capital assets. Surpluses reduce Net Debt while deficits and purchases of tangible capital assets increase Net Debt.

At March 31, 2016, Net Debt had increased by approximately $4.8 billion from its low point in 2011-12, primarily the result of deficits totaling $3.8 billion in the 2012-13 through 2015-16 fiscal years plus the impact of tangible capital asset acquisition during this period.

Observations

23. Net Debt of the Province at March 31, 2016, was $12.6 billion, an increase of $2.3 billion from the previous year and the highest level in Province's history.

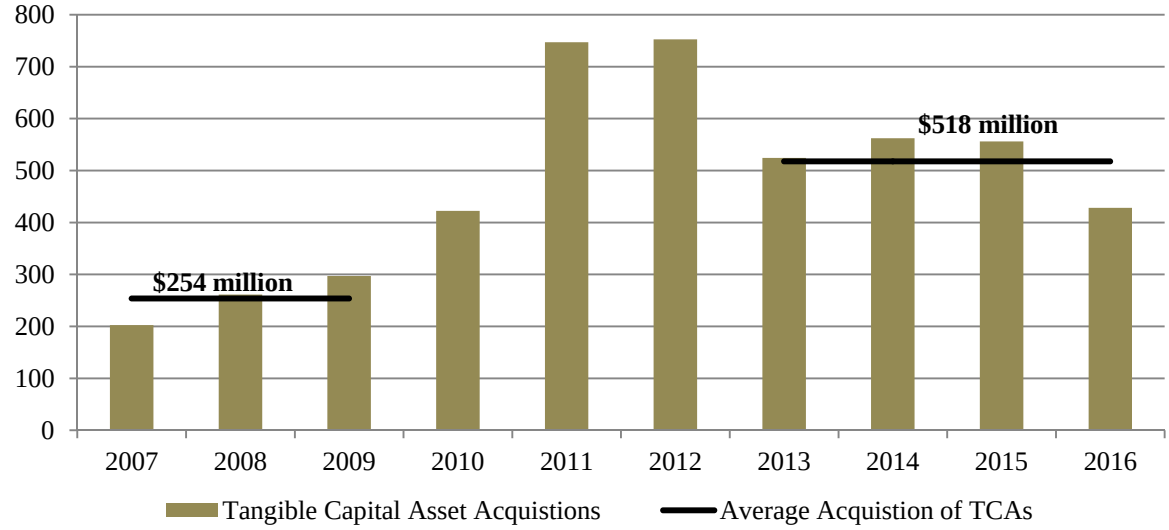
24. At March 31, 2016, Net Debt had increased by approximately $4.8 billion from its low point in 2011-12, primarily the result of deficits totaling $3.8 billion in the 2012-13 through 2015-16 fiscal years plus the impact of tangible capital asset acquisitions during this period.

Tangible Capital Assets (Infrastructure)

Tangible capital assets represent the physical infrastructure of the Province (excluding those owned by GBEs), and includes hospitals, schools and roads. The cost of the infrastructure asset must be financed in the year it is acquired or built and increases Net Debt in that year. The cost of the asset is included as an expense evenly over the estimated life of the asset and impacts deficits over time.

Chart 10

Consolidated Summary Financial Statements
Tangible Capital Asset acquisitions
Years ended March 31
($ Millions)



From 2007 through 2009, annual spending on tangible capital assets averaged $254 million. Spending spiked after the recession of 2008 and 2009 as governments supported the economy through spending on infrastructure. While the Province reduced infrastructure spending by $128 million during 2016, the Province's annual spending on infrastructure has averaged $518 million from 2013 through 2016 – approximately double the spending that occurred from 2007 through 2009.

Any initiative designed to reduce the deficit and, by extension, control the growth in Net Debt will have to consider the appropriate level of annual spending on new infrastructure in the Province.

Observations

25. While the Province reduced infrastructure spending by $128 million during 2016, the Province's annual spending on infrastructure has averaged $518 million from 2013 through 2016 – approximately double the spending that occurred from 2007 through 2009.

26. Any initiative designed to reduce the deficit and, by extension, control the growth in Net Debt will have to consider the appropriate level of spending on new infrastructure in the Province.

2016-17 to 2022-23

The Province is forecasting a deficit of about $1.5 billion in 2016-17. This will increase the Province's Net Debt to $14.6 billion at March 31, 2017, the highest level of Net Debt in the Province's history.

In the absence of specific action, the Province is expecting deficits in each of the subsequent six years to 2022-23 which could likely extend beyond that period. These deficits, totaling almost $4.3 billion, combined with spending on infrastructure over the period will further increase Net Debt. There is insufficient detail provided in Budget 2016 or the 2016 Fiscal and Economic Update to be able to assess the level of expected Net Debt by 2022-23.

Over the period 2016-17 to 2022-23, the Province expects to borrow approximately $8.0 billion in the capital markets. This borrowing will be used to:

- Re-finance existing debt as it comes due.

- Make the required payments under the promissory notes issued as part of changes made to the public service and teachers' pension plans.

- Finance deficits and infrastructure acquisitions.

- Fund the Province's currently expected share of equity for the Muskrat Falls project. Any additional cost overruns on the Muskrat Falls project would require additional equity and borrowings by the Province.

Observations

27. The Province's Net Debt is forecast to increase to $14.6 billion by March 31, 2017, the highest level of Net Debt in the Province's history.

28. Deficits, totaling almost $5.8 billion, combined with spending on infrastructure from 2016-17 to 2022-23 are expected to increase Net Debt.

29. Over the period 2016-17 to 2022-23, the Province expects to borrow $8.0 billion in the capital markets to:

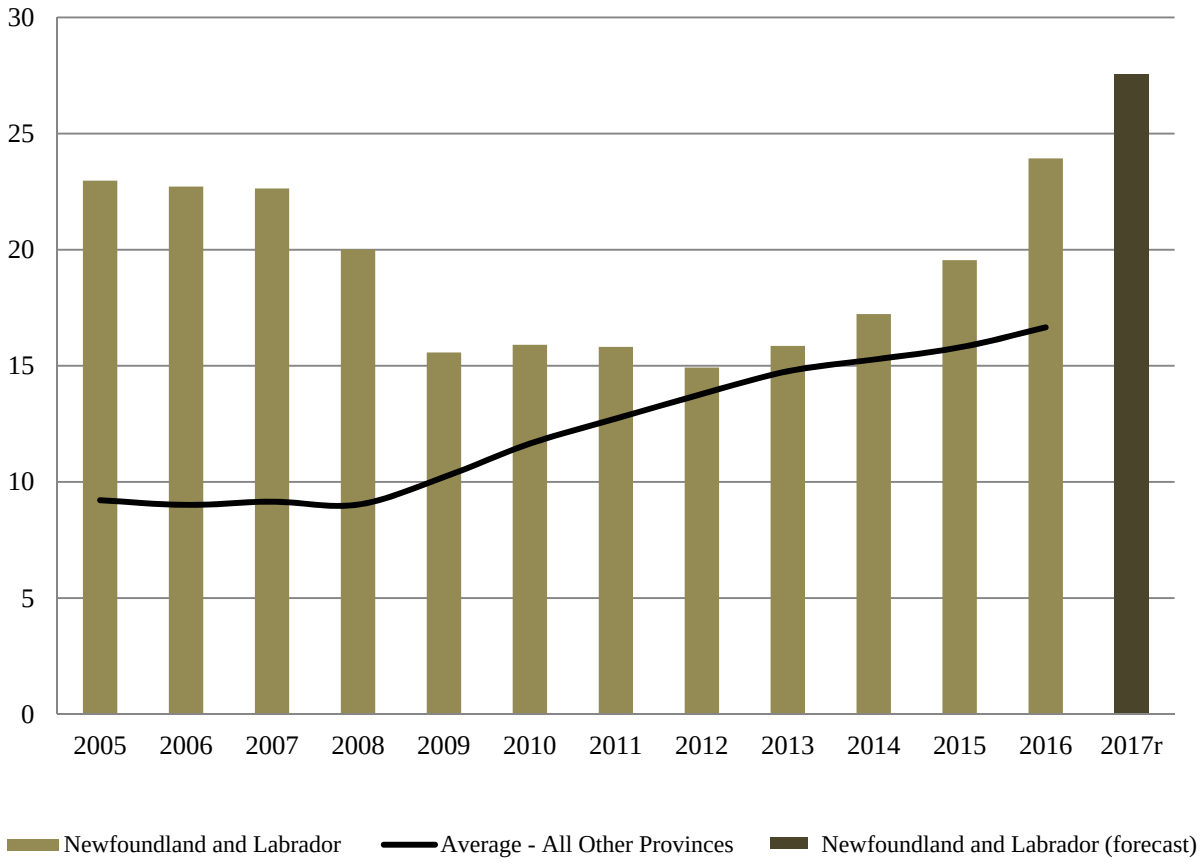
    - Re-finance existing debt as it comes due.
    - Satisfy commitments under the promissory notes issued as part of the pension reform process.
    - Finance deficits and infrastructure spending.
    - Fund the Province's currently expected share of equity for the Muskrat Falls project. Any additional cost overruns on the Muskrat Falls project would require additional equity and borrowings by the Province.

Net Debt per Capita

Net Debt per capita is a measure of the burden of the Province's debt which is borne by each resident of the Province.

Chart 11

Province of Newfoundland and Labrador
Net Debt per Capita
Years ended March 31
($ 000s)



Source: Public Accounts - all provinces; Statistics Canada; Department of Finance (forecast)

For several years, the Province's Net Debt per capita was approaching the average of all other provinces and at March 31, 2012, had reached its lowest point at $14,930. This occurred as a result of an improvement in both the Province's Net Debt and population from 2008 to 2012. The average of all other provinces deteriorated during that same period.

At March 31, 2016, Net Debt per capita has risen to $23,934, the highest in the Province's history. Net Debt per capita is expected to rise to $27,542 by March 31, 2017. Furthermore, the Province's position relative to other provinces is deteriorating and the trend is expected to continue, especially since the Province is projecting deficits until 2022-23. Over this period, Net Debt is expected to increase significantly as a result of the projected deficits and the population is expected to decline from current levels.

Observation

30. By March 31, 2017, Net Debt per capita is expected to reach $27,542. This level is the highest in the Province's history and would represent a significant financial burden for each and every Newfoundlander and Labradorian.

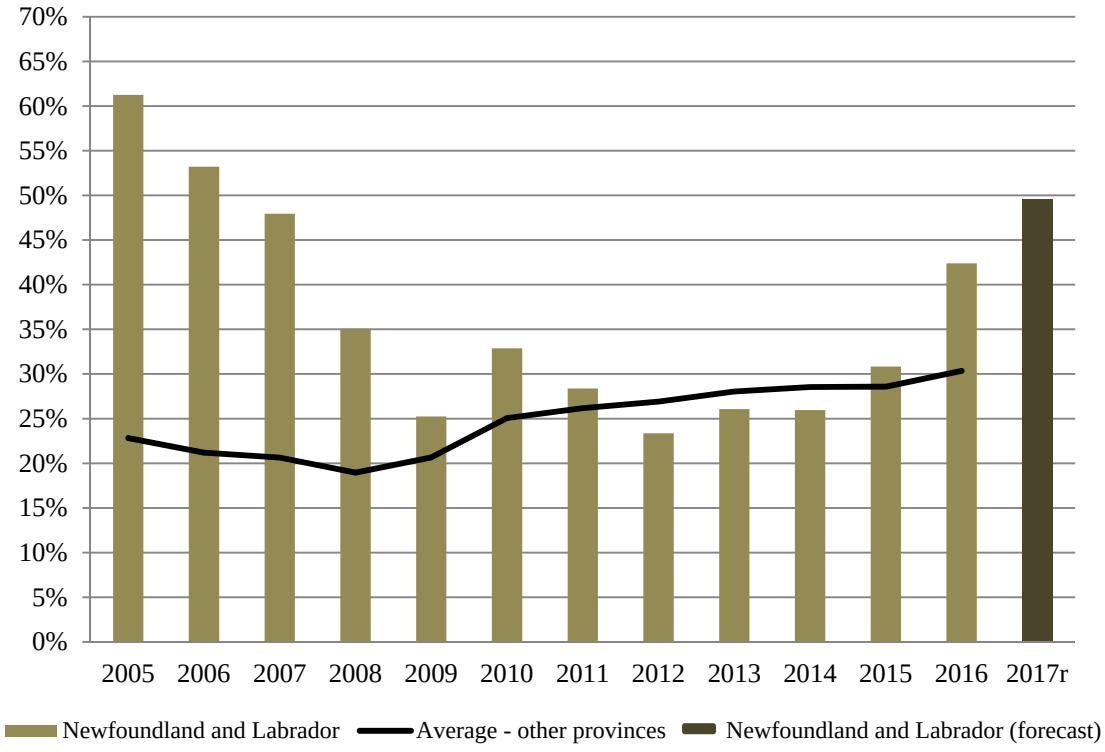
Net Debt as a percentage of GDP

A second commonly used indicator to measure a province's financial position is Net Debt as a percentage of GDP. This indicator is perhaps the most widely used and relates provincial Net Debt to the size of the economy that supports the debt level. Because it is a relative measure, it is also used to compare jurisdictions to one another.

GDP is an indicator of the ability of the Province to raise revenue and support debt. The financial demands placed on the economy by Government spending and revenue raising practices can be assessed for sustainability by comparing the level of Net Debt to provincial GDP. When a province's Net Debt as a percentage of GDP is high, it is an indication that the level of Net Debt may not be sustainable.

Chart 12

Province of Newfoundland and Labrador
Net Debt as a percentage of GDP
Years ended March 31



Source: Public Accounts - all provinces; Statistics Canada; Economic Updates - all provinces

Net Debt as a percentage of GDP had declined from a high of 61.3% at March 31, 2005, to a low of 23.4% at March 31, 2012. At that time, the Net Debt to GDP ratio of Newfoundland and Labrador was lower than the average of all other provinces.

However, at March 31, 2016, the Province's Net Debt as a percentage of GDP has climbed to 42.4% and is now higher than the average of all other provinces. Furthermore, by March 31, 2017, the Province's Net Debt as a percentage of GDP is forecasted to increase to 49.5%. The expectation of continued deficits beyond 2016-17 will continue to increase the ratio of Net Debt to GDP in the future.

Observation

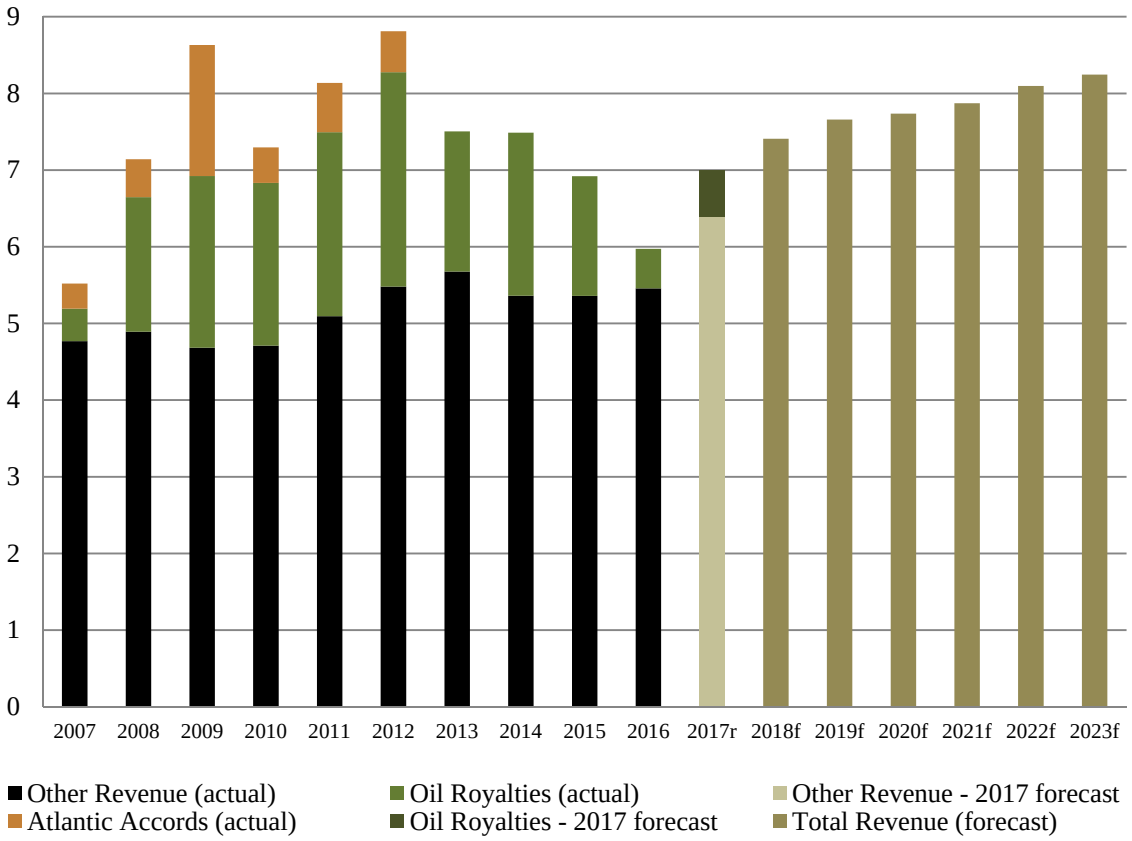
31. Net Debt as a percentage of GDP is forecast, by the Province, to increase to 49.5% at March 31, 2017. The expectation of continued deficits beyond 2016-17 will continue to increase the ratio of Net Debt to GDP in the future.

Revenues

As a Province with a heavy reliance on natural resources, revenues are subject to volatile swings. This is typical of the resource sector. This volatility is manifesting itself to an extreme level in 2015-16 and 2016-17.

Chart 13

Province of Newfoundland and Labrador
Revenue
Years ended March 31
($ Billions)



Source: Public Accounts (actual); Department of Finance (forecast)

Revenue (excluding revenue received under the Atlantic Accord arrangements) peaked in 2011-12 at $8.3 billion. Total revenue in 2015-16 was $6.0 billion, a reduction of $948 million from the previous year and a reduction of $2.3 billion from the peak in 2011-12.

For 2016-17, oil royalties are now forecast to be $601 million. While the significant decline in the price of oil is a contributing factor to the revenue drop, declines in production are also having a negative impact. This highlights the inherent volatility associated with revenue from natural resources and, in particular, oil.

By 2022-23, the Province is forecasting that total revenue will increase an average of 5.4% a year to reach $8.2 billion. This represents an increase of $2.2 billion in annual revenue over the seven year period.

This growth in revenue is dependent on the Province achieving the expected economic growth and the levels of oil production and oil price forecast in Budget 2016.

Considerable risk surrounds the Province being able to achieve these targets. The economic forecast is subject to influence from external and internal factors, oil production will depend on factors such as geology, reservoir management and operational issues and there does not appear to be any firm consensus around the future of long-term oil prices.

Observations

32. For the year ended March 31, 2016, total revenue was $2.3 billion below the peak achieved in 2011-12.

33. For 2016-17, oil royalties are forecast to be $601 million, well below the $2.8 billion recorded in 2011-12.

34. The Province is forecasting revenue to grow by $2.2 billion over the seven year period to 2022-23. This growth in revenue is dependent on the Province achieving the economic growth and the levels of oil production and oil price forecast in Budget 2016. Considerable risk surrounds the Province being able to achieve these targets.

Oil Royalties

The development of the offshore oil sector has had a significant impact on the overall economy of Newfoundland and Labrador and has resulted in a growing reliance by Government on oil royalties to fund its programs and services. In 2011-12, oil royalties peaked at $2.8 billion and represented 33.8% of total revenue (excluding the Atlantic Accord). By 2015-16, oil royalties dropped to $515 million and only represented 8.6% of total revenues. In 2016-17, the Province is expecting oil royalties of $601 million – still 8.6% of total revenue.

Observations

35. Oil royalties in 2015-16 were $515 million, a drop of $2.3 billion from the peak of $2.8 billion in 2011-12.

36. In 2016-17, oil royalties are expected to account for just 8.6% of revenue, a significant drop in five years from the peak of 33.8% in 2011-12.

This highlights the volatile nature of this revenue source. The volatility is inherent in the components that impact royalties - production and price, factors that are outside the control of the Province.

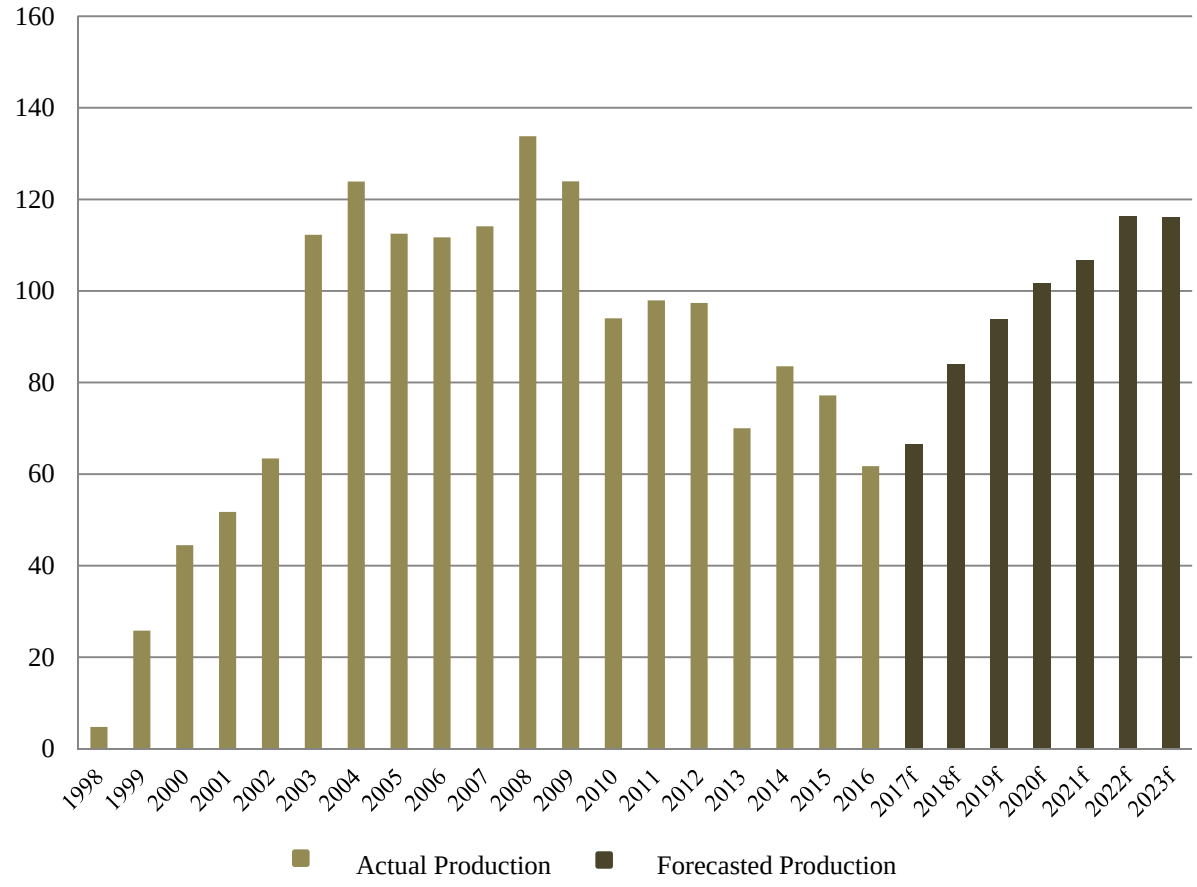
Given its lack of control over the factors that impact oil royalties, and the significant reliance on this revenue source, Government has to carefully consider the degree to which it can rely on this revenue source to fund its programs and services in the future.

Oil Production

Oil production commenced in the Newfoundland and Labrador offshore area in 1997 and peaked in 2007-08 at 133.8 million barrels. Since that time, production has been on a downward trend and totaled 61.7 million barrels in 2015-16.

Chart 14

Province of Newfoundland and Labrador
Annual oil production
Years ended March 31
(Million barrels)



Source: Canada-Newfoundland and Labrador Offshore Petroleum Board, October 2016 (Actual)
Department of Finance (forecasted)

Production is currently forecast by the Province to increase each year, commencing with 2016-17. The increase in production is attributed, primarily, to the commencement of production from the Hebron field, expected toward the end of 2017. By 2022-23, oil production is forecast to be 116.1 million barrels. While this represents a significant increase in production since 2015-16, it is still below the peak production of 133.8 from 2007-08.

Observation

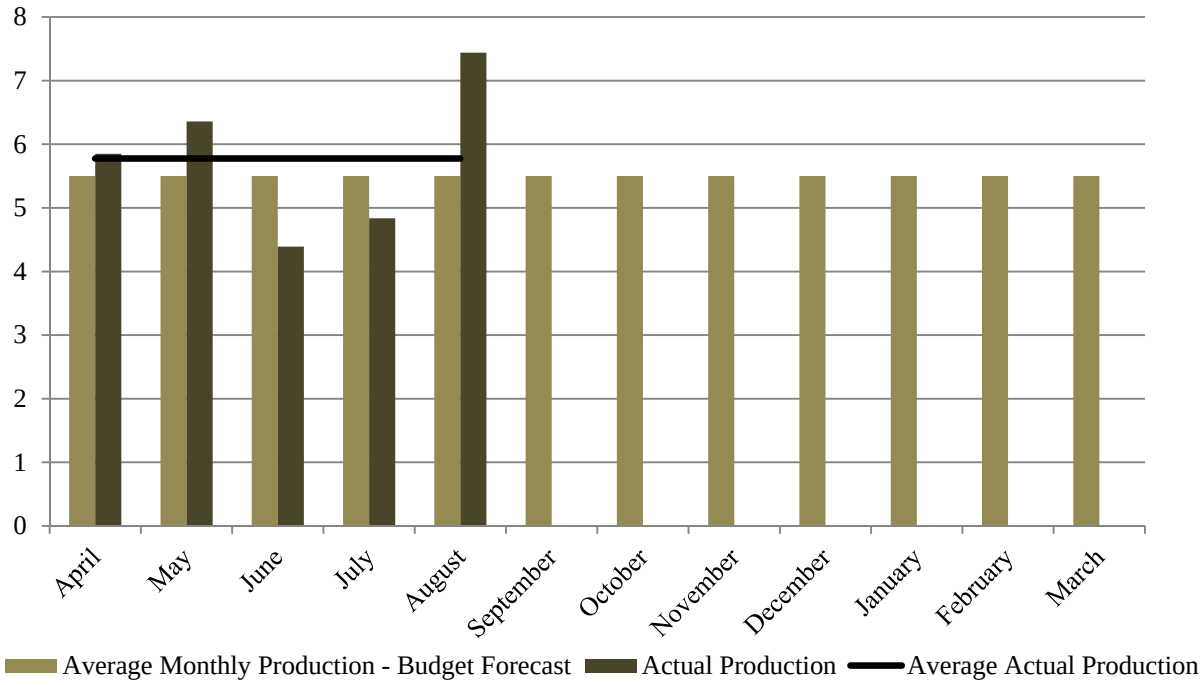
37. Annual production of offshore oil has shown a downward trend since 2007-08, but is expected to increase with the commencement of production from the Hebron field.

2016-17

Production for 2016-17 had initially been forecast to be 66.4 million barrels in Budget 2016 – an average of 5.5 million barrels per month.

Chart 15

Province of Newfoundland and Labrador
Oil production
Year ended March 31, 2017
(Million barrels)



Source: Budget: Department of Finance
Actual: Canada-Newfoundland and Labrador Offshore Petroleum Board, October 2016

From April to August 2016, average actual monthly production has exceeded the average forecasted monthly production; however, actual monthly production has varied considerably. There is still risk that the production forecast may not be achieved.

Observation

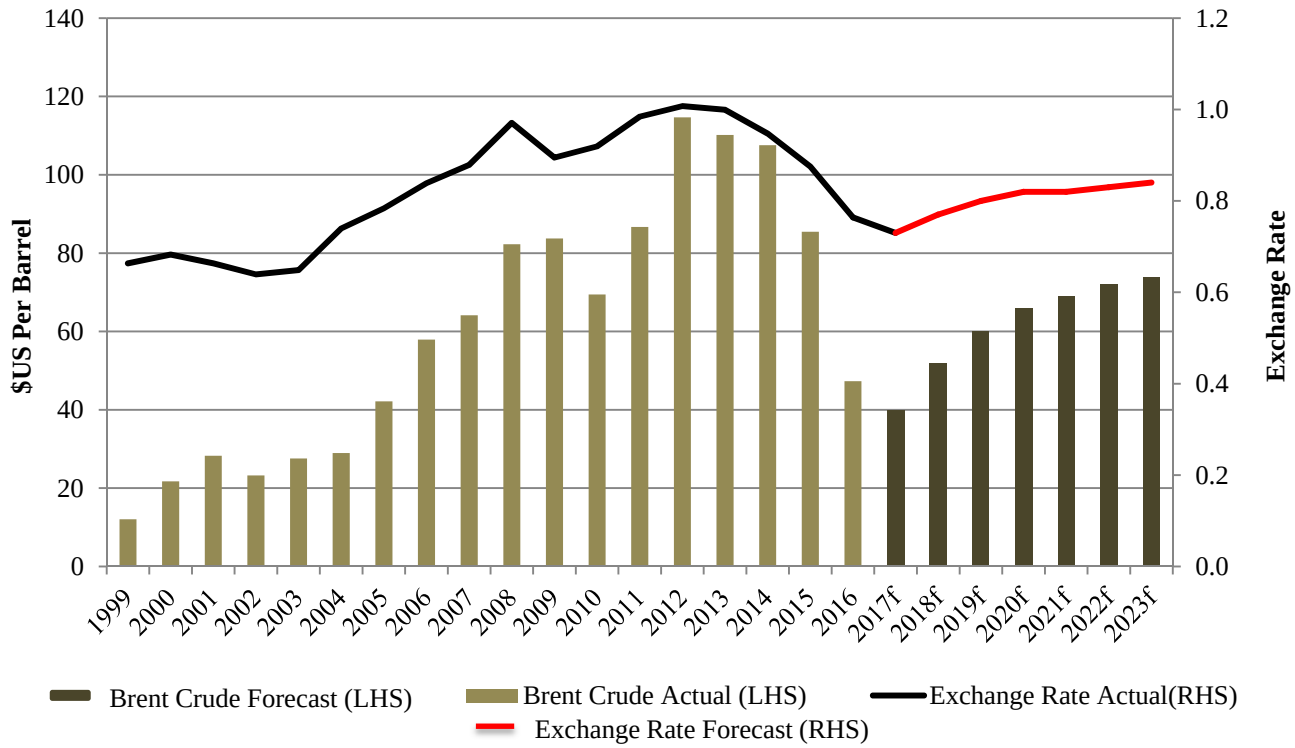
38. From April to August 2016, average actual monthly production has exceeded the average forecasted monthly production; however, actual monthly production has varied considerably. There is still risk that the production forecast may not be achieved.

Oil Price

The price of Brent Crude, which is quoted in US dollars, and the Canada-US exchange rate are subject to significant fluctuation.

Chart 16

Brent Crude - Average Monthly Spot Price
Canada - US exchange rate
Years ended March 31



Source: US Department of Energy – Energy Information Administration (Brent Crude price)
Bank of Canada – (Canada-US Exchange Rate)
Department of Finance (forecasted information)

2015-16

The average annual price of Brent Crude peaked in 2011-12 at $US114.65 per barrel. Since then, the price has steadily declined and in 2015-16 the average price of Brent crude was $US47.30.

Observation

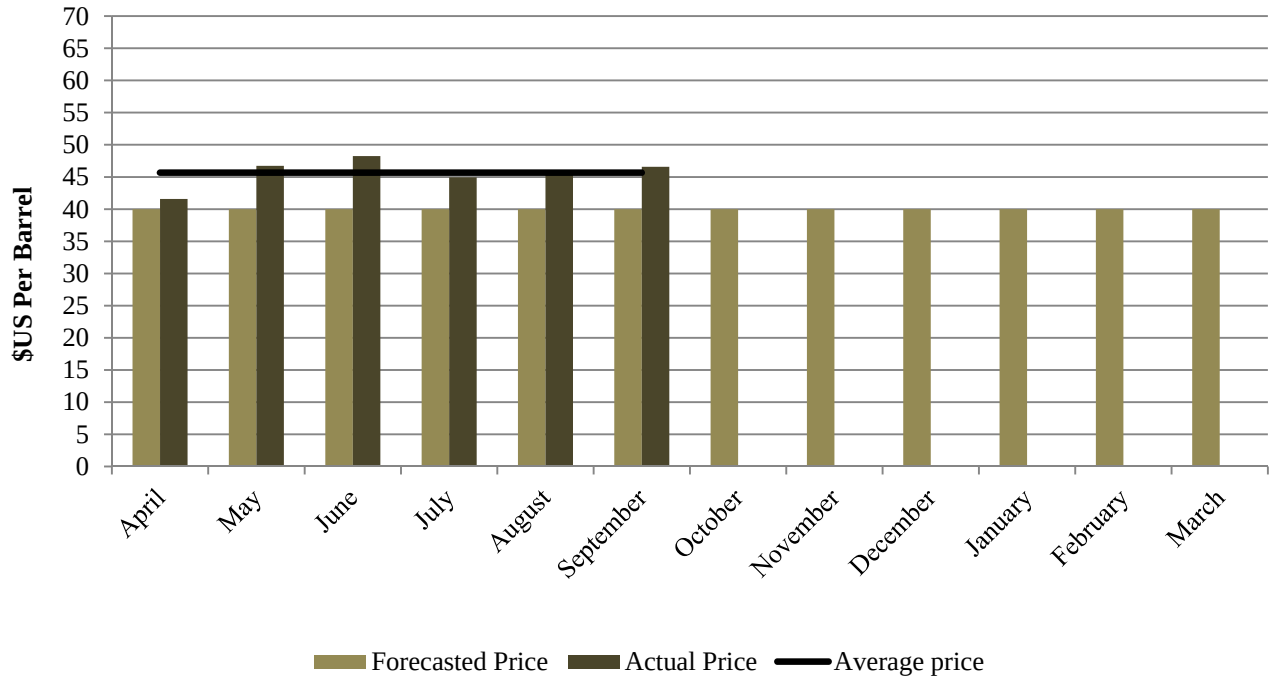
39. The average annual price of Brent Crude peaked in 2011-12 at $US114.65 per barrel and has been steadily declining since that time. In 2015-16, the price of Brent crude averaged $US47.30 per barrel.

2016-17

Budget 2016 had forecast the price of Brent crude to be $US40 per barrel for 2016-17.

Chart 17

Province of Newfoundland and Labrador
Oil price
Year ended March 31, 2017



Source: US Department of Energy - Energy Information Administration (Brent Crude price) - actual
Department of Finance - forecast

The price of Brent crude has averaged $US45.66 from April to September 2016, which exceeded the forecasted average price. Some risk remains around oil prices for the remainder of the fiscal year.

Observation

40. Forecasting the price of oil involves risk. During 2016-17 to date, the actual average price of Brent crude has exceeded the forecasted average price.

2017-18 to 2022-23

Of greater risk is the forecast from 2017-18 to 2022-23. The farther in the future the forecast goes, the greater the risk around predicting the oil fundamentals at that time. The Province will have to closely monitor oil prices as it manages the deficit and adjust as circumstances warrant.

The Province is forecasting the price of Brent crude to average $US52 in 2017-18 and expects to see steady annual increases to $US74 per barrel by 2022-23. This increase in Brent crude will not be enough, on its own, to address the fiscal challenges being faced by the Province. For example, even at an average Brent crude price of $US85 per barrel, the Province recorded a deficit of $986 million in 2014-15.

Observation

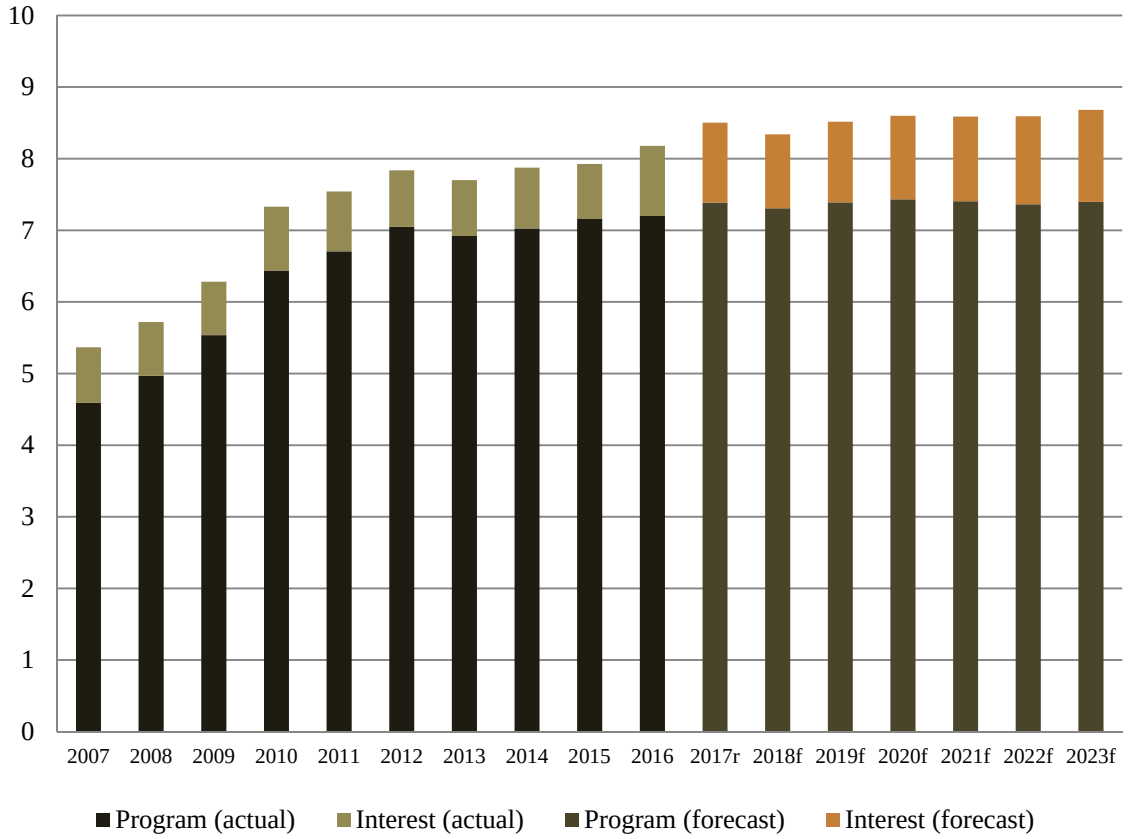
41. The Province is forecasting the price of Brent crude to average $US52 in 2017-18 and expects to see steady annual increases to $US74 per barrel by 2022-23. This increase in Brent crude will not be enough, on its own, to address the fiscal challenges being faced by the Province.

Expenses

Total expenses have grown from $5.4 billion in 2006-07 to $8.2 billion in 2015-16, an increase of $2.8 billion or 52%.

Chart 18

Province of Newfoundland and Labrador
Expenses
Years ended March 31
($ Billions)



Source: Public Accounts (actual); Department of Finance (forecast)

The current forecast to 2022-23 indicates further growth in total expenses of $0.5 billion or 6.1%, primarily the result of increases in debt servicing expenses.

Observation

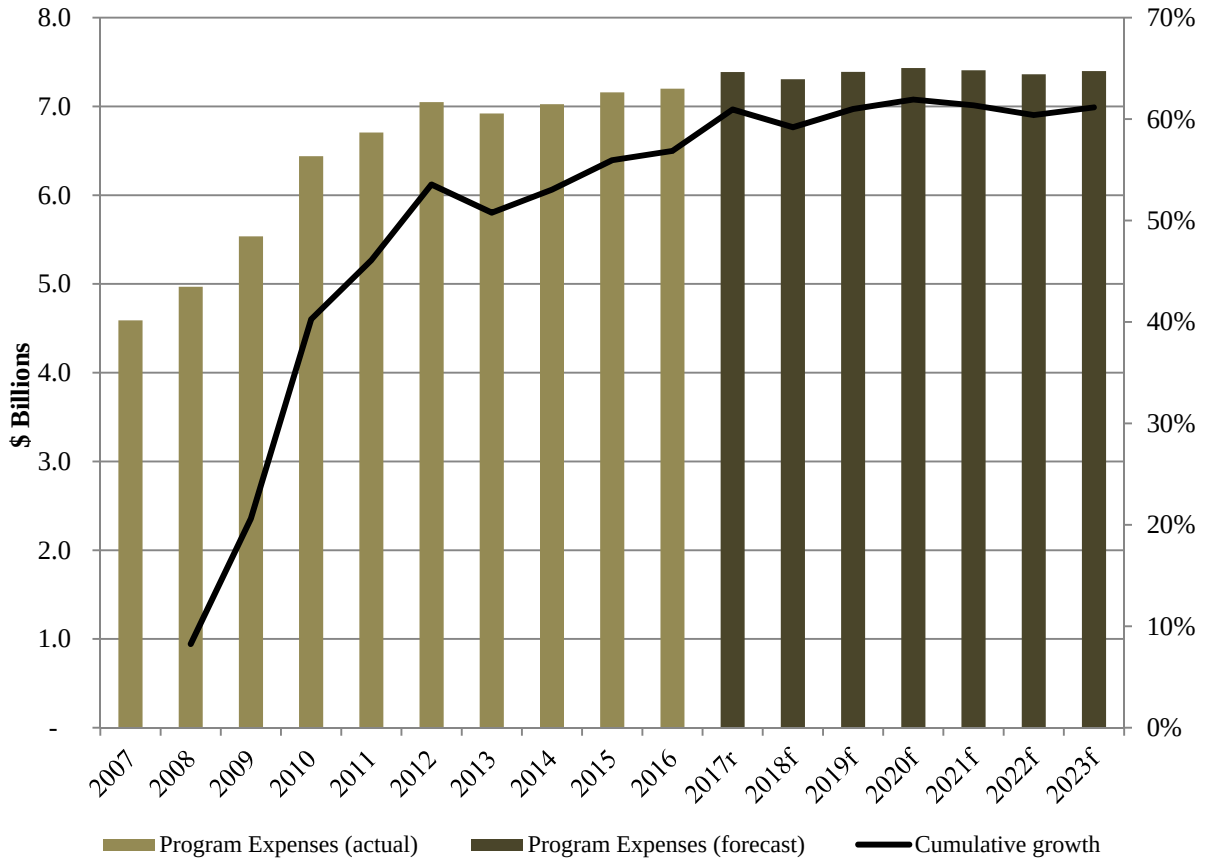
42. Total expenses have grown from $5.4 billion in 2006-07 to $8.2 billion in 2015-16, an increase of $2.8 billion or 52%.

Program Expenses

Program expenses include all those expenses incurred by the Province other than those required to service Net Debt.

Chart 19

Province of Newfoundland and Labrador
Program expenses and cumulative growth
Years ended March 31



Source: Public Accounts (actual); Department of Finance (forecast)

2006-07 to 2015-16

Since 2006-07, program expenses have grown by $2.6 billion to $7.2 billion in 2015-16. This represents cumulative growth over that period of 56.9%. The largest portion of this growth occurred between the period 2006-07 and 2009-10, a period when the Province was experiencing strong revenue growth.

While growth in program expenses slowed between 2011-12 and 2015-16, an additional $152 million was added to program expenses over that period.

Observation

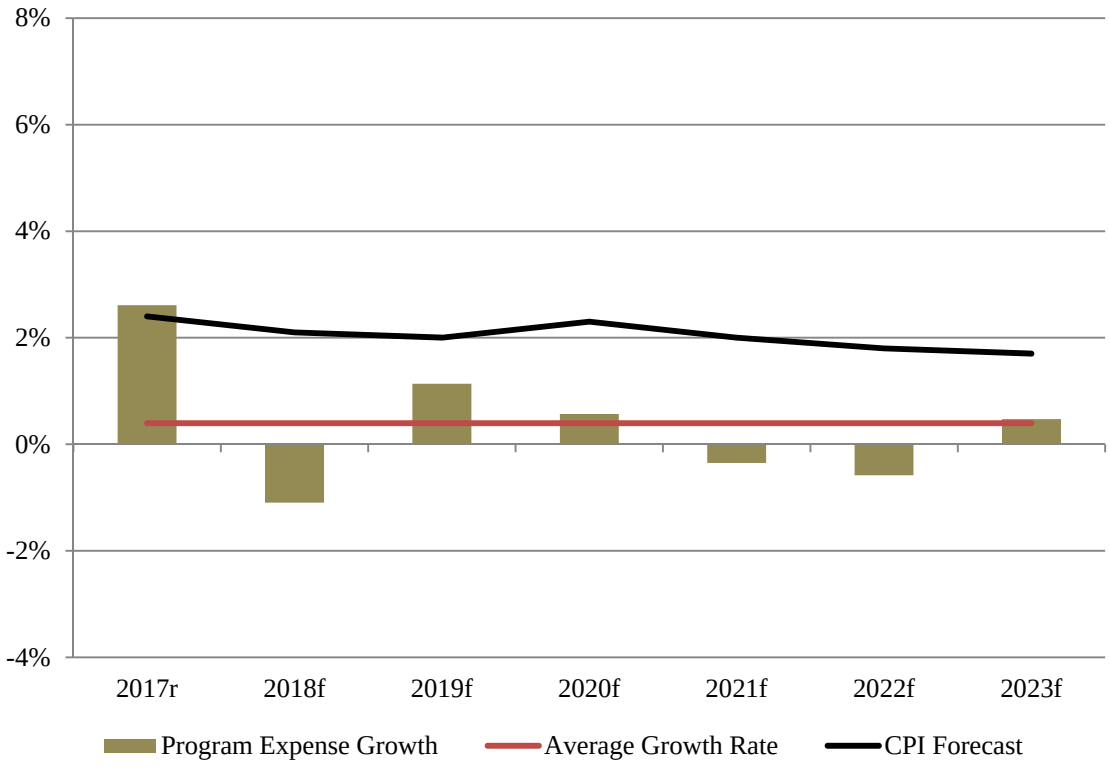
43. Program expenses have grown by 56.9% over the ten year period from 2006-07 to 2015-16.

2016-17 to 2022-23

In Budget 2016, the Province updated its forecast of expected levels of expenses to 2022-23 before any specific action to manage expenses as part of an exercise to reduce the size of the anticipated deficits. The 2016 Fiscal and Economic Update provided the Province's revised expectations for 2016-17.

Chart 20

Province of Newfoundland and Labrador
Forecast program expense growth
Years ended March 31



Source: Department of Finance

The forecast expects average program expense growth of 0.4% from 2016-17 to 2022-23, which is less than the Province's expected CPI growth over the same period. Therefore, the growth in program expenses of $197 million would not allow for inflationary or other pressures. A $436 million deficit is still anticipated in 2022-23 despite this forecast of modest expense growth.

Observations

44. Program expenses are forecast to increase by approximately $197 million between 2015-16 and 2022-23, an average growth rate of only 0.4%. This level of expense increase is less than the expected rate of inflation and would not allow for inflationary or other pressures.

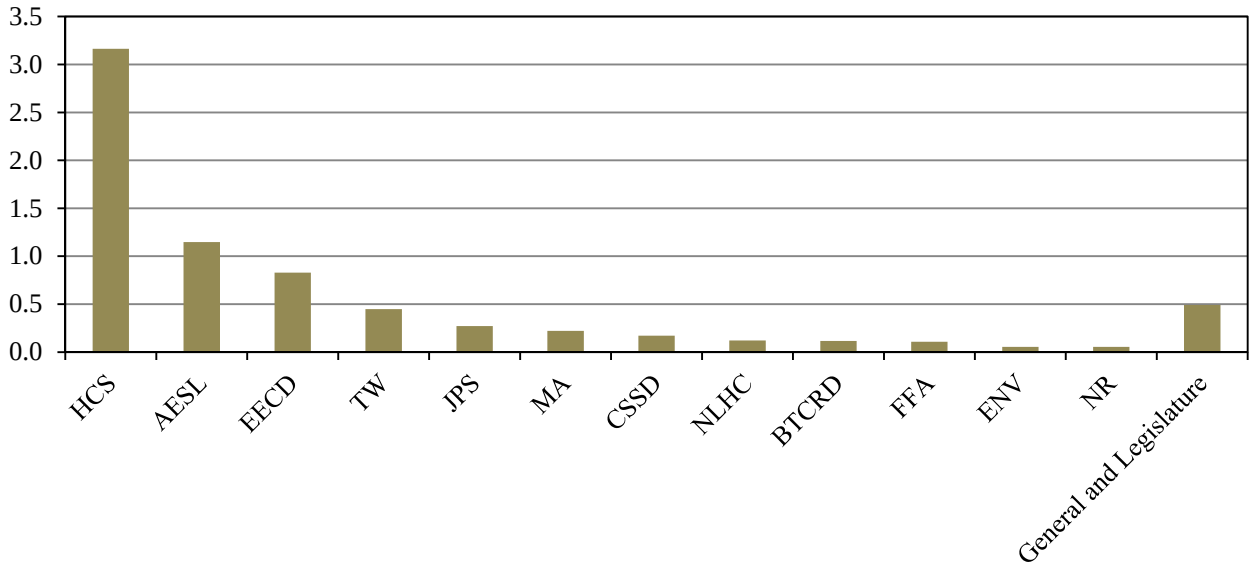
45. A $436 million deficit is still anticipated in 2022-23 despite a forecast of modest expense growth.

Program Expenses by Department

Government program expenses are predominantly targeted to areas of social need.

Chart 21

Consolidated Summary Financial Statements
Program Expenses by Department
Year ended March 31, 2016
($ Billions)



$3.2 billion of the $7.2 billion of program expenses incurred in 2015-16 were attributed to the Department of Health and Community Services. This would include the operations of the four regional health authorities across the Province. Of every program expense dollar spent in Newfoundland and Labrador, 44% is spent on health care.

The Departments of Advanced Education, Skills and Labour, and Education and Early Childhood Development, combined, account for $2.0 billion in program expenses, or almost 28% of the total. This includes spending on the K-12 system, the university and college, as well as income support and skills development.

Almost 72% of program expenses are directed to the health, education and skills development sectors.

Observations

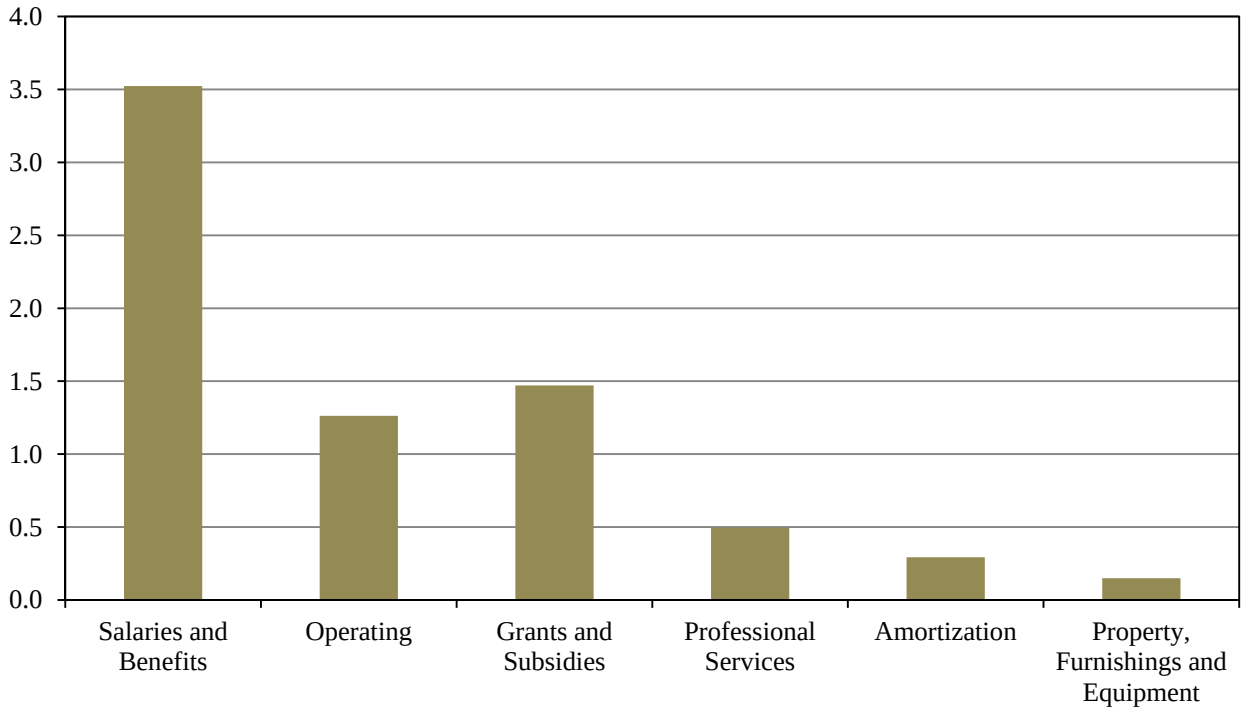
46. Almost 72% of program expenses are directed to the health, education and skills development sectors.

Program Expenses by Category

Government provides services to residents throughout the Province.

Chart 22

Consolidated Summary Financial Statements
Program Expenses by Category
Year ended March 31, 2016
($ Billions)



As with any organization providing a service or services, the Province spends the majority of its expenses on human resources – its employees. In 2015-16, the Province spent $3.5 billion on salaries and employee benefits which represents 49% of the total program spending of Government.

Not only is 72% of spending directed to health, education and skills development, but, 49% of costs are related to people.

Observation

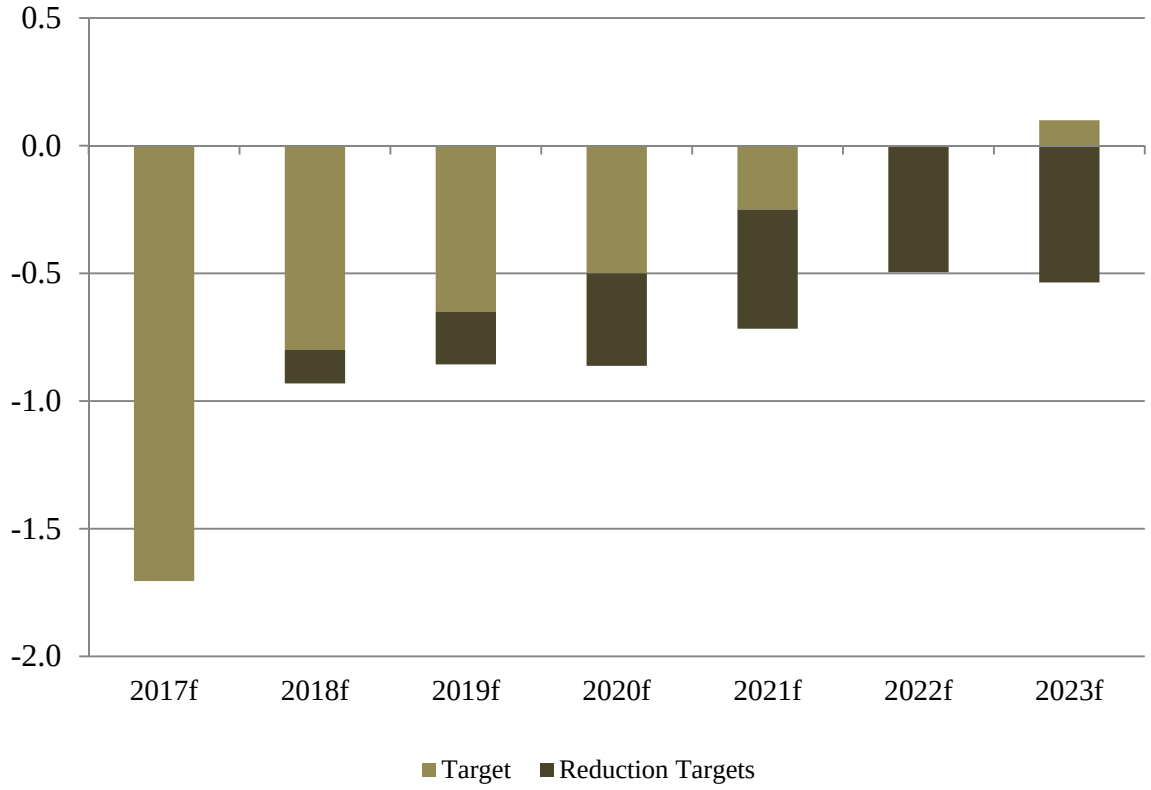
47. In 2015-16, the Province spent $3.5 billion on salaries and employee benefits which represents 49% of the total program spending of Government.

Deficit Reduction Targets

Budget 2016 outlined the Province's target to reduce the deficit.

Chart 23

Province of Newfoundland and Labrador
Forecasted Deficits and Targets
Years ended March 31
($ Billions)



Source: Department of Finance

These targets will have to be achieved through a combination of revenue increases and expense decreases. Given that 72% of program expenses are directed towards health, education and skills development and 49% of program expenses are on salaries and benefits, any measures to reduce expenses in a substantive way, will, by necessity, have to focus on these areas.

Observation

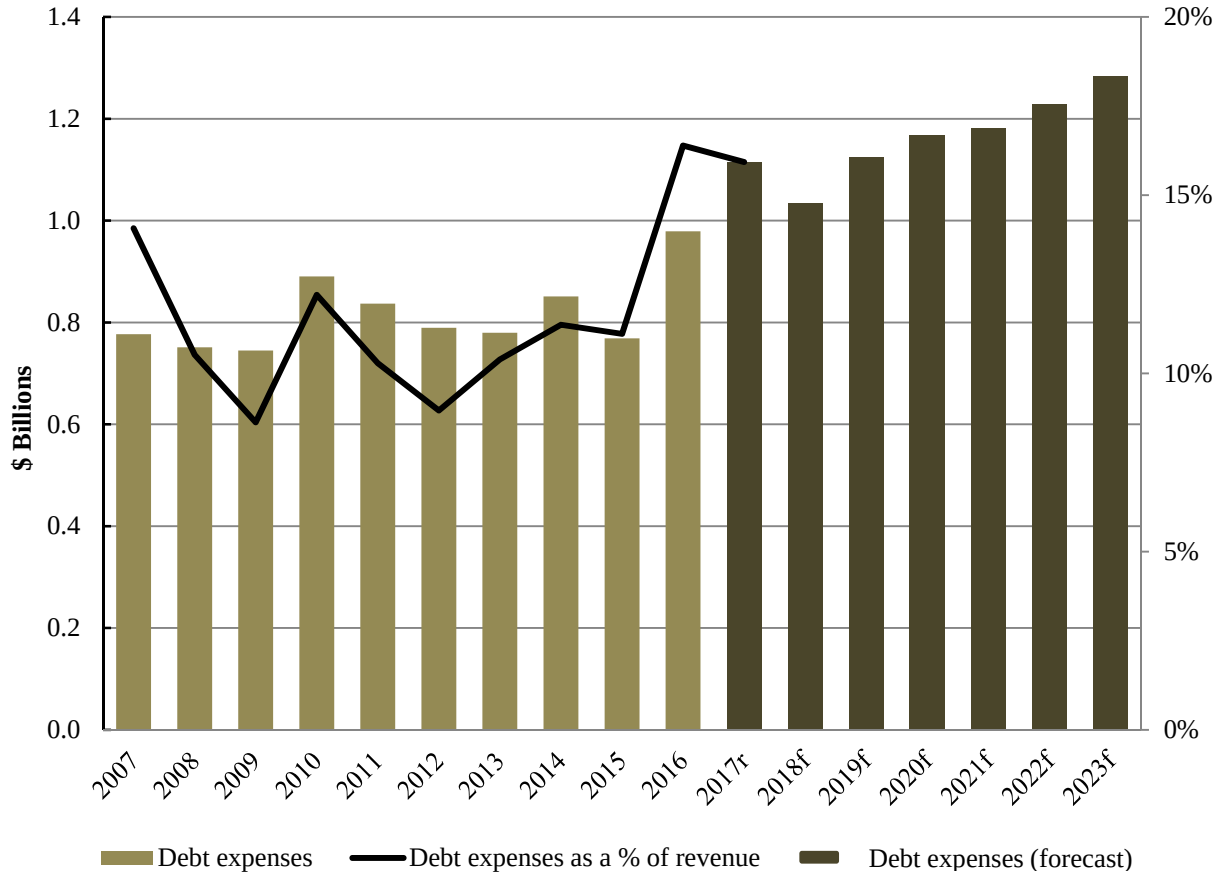
48. Given that 72% of program expenses are directed towards health, education and skills development and 49% of program expenses are on salaries and benefits, any measures to reduce expenses in a substantive way, will, by necessity, have to focus on these areas.

Interest costs

Government incurs interest costs on its borrowings, as well as on its liabilities related to employee post-retirement benefits. At March 31, 2016, Government borrowings, net of sinking funds, were $9.1 billion, its unfunded pension liability was $4.7 billion and its unfunded group health and life insurance retirement benefits liability was $2.8 billion.

Chart 24

Province of Newfoundland and Labrador
Debt expenses and as a percentage of revenue
Years ended March 31



Source: Public Accounts (actual); Department of Finance (forecast)

From 2006-07 to 2015-16 interest expense averaged $817 million. In Budget 2016, the Province forecast debt servicing expenses to be $982 million for 2016-17 and then steadily rising to reach $1.3 billion by 2022-23. The October 2016 Fiscal and Economic Update revised forecast debt servicing expenses for 2016-17 upward by $132 million to an expected $1.1 billion. The Province has not provided an update of anticipated interest cost to 2022-23, but it can be reasonably expected that annual debt servicing costs in each of 2017-18 to 2022-23 will rise each year to reflect the $132 million increase in 2016-17. This represents an additional potential cumulative interest and deficit cost of almost $1.0 billion over the next seven years.

Money allocated to servicing debt is money that is not available to fund programs and services.

Interest costs as a percentage of revenue, sometimes called the "interest bite", is an important indicator of the state of government finances. It indicates how much of a province's revenues first must go to pay for past borrowings before being able to fund current Government programs. Debt expenses as a percentage of revenue has increased overall since 2007 and is at 16.4% for 2015-16 and expected to be 15.9% for 2016-17.

Observations

49. The Fiscal and Economic Update indicates an expected increase of $132 million in interest costs in 2016-17 beyond what was forecast in Budget 2016. It can be expected that this increase will follow in each year of 2017-18 to 2022-23 with the potential to add at least $1.0 billion to cumulative interest costs and deficits over that period.

50. Money allocated to servicing debt is money that is not available to fund programs and services.

51. By 2016-17, approximately 15.9 % of every dollar of revenue generated is forecast to be allocated to interest expense.

CHAPTER 4

FINANCIAL ACCOUNTABILITY

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Background

This Report provides information on the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador for the year ended March 31, 2016. These financial statements are the principal means by which Government reports to the House of Assembly and to all Newfoundlanders and Labradorians on its stewardship of public funds.

Legislative Requirements

In accordance with section 59 of the *Financial Administration Act (FAA)*, Government prepares a report called the Public Accounts. In accordance with the *FAA*, the Public Accounts must show:

- the state of the public debt;
- the revenue and expenditure;
- all compromises, remissions, refunds and amounts written off; and
- those other accounts and statements that may under good accounting practice be required to show the financial position of the Province at the end of the fiscal year.

Under section 19 of the *Transparency and Accountability Act*, the Comptroller General is required to include (consolidate) the audited financial statements of Government entities in the Public Accounts.

Treasury Board prescribes the manner and form in which the Public Accounts of the Province are prepared, as provided by the *FAA*.

Section 11 of the *Auditor General Act* requires that the Auditor General express an opinion as to whether the financial statements required by the *FAA* to be included in the Public Accounts present fairly the financial position, results of operations and changes in the financial position of the Province in accordance with the disclosed accounting policies of the Provincial government and on a basis consistent with that of the preceding year, together with reservations the Auditor General may have.

Consolidated Summary Financial Statements

The Consolidated Summary Financial Statements reflect the financial position and annual operating results of all organizations in the Government Reporting Entity (GRE). The statements provide the most complete information about the operating results and financial position of the Province. They combine the results of operations of the Consolidated Revenue Fund, which accounts for the financial activities of the central Government, Legislature and departments, with those of other Government entities.

The GRE consists of the Legislature, government departments and all organizations the Province controls. Control is defined as the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities.

Organizations in the GRE are shown in Table 1. The organizations in the GRE include Government Business Enterprises (GBEs), a Government Business Partnership, school districts, health boards, government not-for-profit organizations, and other government organizations.

GBEs and Government Business Partnerships generate their revenues by selling goods or services outside of the GRE. Their operations are self-sustaining - they do not rely on government funding. The GBEs are Nalcor Energy and the Newfoundland and Labrador Liquor Corporation. The Province's only Government Business Partnership is its 25% equity interest in the Atlantic Lottery Corporation Inc. The accounting for GBEs and Government Business Partnerships is significantly different from all of the other organizations in the GRE, reflecting their self-sustaining nature.

Table 1

Consolidated Summary Financial Statements
Government Reporting Entity
March 31, 2016

Audited by the Office of the Auditor General	Audited by a Private Sector Auditor
Business Investment Corporation	Atlantic Lottery Corporation Inc.
C.A Pippy Park Commission	Board of Commissioners of Public Utilities
Consolidated Revenue Fund	Central Regional Health Authority
Heritage Foundation of Newfoundland and Labrador	Chicken Farmers of Newfoundland and Labrador
Livestock Owners Compensation Board	College of the North Atlantic
Newfoundland and Labrador Arts Council	Conseil scolaire francophone provincial de Terre-Neuve et Labrador
Newfoundland and Labrador Crop Insurance Agency	Credit Union Deposit Guarantee Corporation
Newfoundland and Labrador Housing Corporation	Dairy Farmers of Newfoundland and Labrador
Newfoundland and Labrador Immigrant Investor Fund Limited	Eastern Regional Health Authority
Newfoundland and Labrador Industrial Development Corporation	Egg Farmers of Newfoundland and Labrador
Newfoundland and Labrador Legal Aid Commission	Labrador-Grenfell Regional Health Authority
Newfoundland and Labrador Municipal Financing Corporation	Marble Mountain Development Corporation
Provincial Advisory Council on the Status of Women - Newfoundland and Labrador	Memorial University of Newfoundland

Audited by the Office of the Auditor General	Audited by a Private Sector Auditor
Provincial Information and Library Resources Board	Multi-Materials Stewardship Board
Research & Development Corporation of Newfoundland and Labrador	Municipal Assessment Agency Inc.
Student Loan Corporation of Newfoundland and Labrador	Nalcor Energy
The Rooms Corporation of Newfoundland and Labrador	Newfoundland and Labrador 911 Bureau Inc.
	Newfoundland and Labrador Centre for Health Information
	Newfoundland and Labrador English School District
	Newfoundland and Labrador Film Development Corporation
	Newfoundland and Labrador Liquor Corporation
	Newfoundland and Labrador Sports Centre Inc.
	Newfoundland Hardwoods Limited
	Newfoundland Ocean Enterprises Limited
	Western Regional Health Authority
Unaudited	
Churchill Falls (Labrador) Corporation Trust	
No Financial Statements Prepared	
Newfoundland and Labrador Farm Products Corporation	

The Consolidated Summary Financial Statements are prepared in accordance with Canadian Public Sector Accounting Standards established for governments by the Public Sector Accounting Board (PSAB) of the Chartered Professional Accountants of Canada. The significant accounting policies of the Province are contained in the notes to the Consolidated Summary Financial Statements.

Under Canadian Public Sector Accounting Standards, a summary reporting model is the only appropriate reporting model for governments. This requires that all entities in the GRE be consolidated in summary financial statements - this model is adopted by the Province of Newfoundland and Labrador.

For the year ended March 31, 2016, the Public Accounts contains the Consolidated Summary Financial Statements, the Independent Auditor's Report on those financial statements, and other information which Government is required to include or chooses to include.

Responsibility for the Public Accounts

Government, through the Comptroller General, is responsible for providing the House of Assembly with the Province's financial statements (the Public Accounts), prepared in accordance with Canadian Public Sector Accounting Standards, the standards which are considered to be generally accepted accounting principles (GAAP) for Canadian governments.

The Comptroller General is responsible for preparing the Consolidated Summary Financial Statements, including related notes and schedules. To prepare financial statements in accordance with GAAP, the Comptroller General is required to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue and expenses.

The Consolidated Summary Financial Statements include a Statement of Responsibility, signed by the Minister of Finance and President of Treasury Board and the Comptroller General. Government is responsible for maintaining a system of internal control in order to provide reasonable assurance that transactions are properly authorized, assets are safeguarded, financial records are properly maintained, and to prepare summary financial statements that are free from material misstatement whether due to fraud or error.

Independent Auditor's Report

The responsibility of the Office of the Auditor General is to perform an audit of the Consolidated Summary Financial Statements in accordance with Canadian generally accepted auditing standards (GAAS). The Office forms an opinion based upon the results of the audit and, in accordance with GAAS, issues an Independent Auditor's Report on the Consolidated Summary Financial Statements.

Some key points about the Independent Auditor's Report are:

Level of Assurance

The audit is designed to obtain reasonable, but not absolute, assurance that the Consolidated Summary Financial Statements, as a whole, are free of material misstatement. It is not possible to provide absolute assurance in a financial statement audit because it is not practical to examine 100% of transactions (due to volume), internal control systems have inherent limitations (due to control override potential), and much audit evidence is persuasive rather than conclusive.

Reasonable assurance means that sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level to support the conclusion that the financial statements are free of material misstatement. This is consistent with GAAS.

Materiality

The Independent Auditor's Report provides an opinion on whether the Consolidated Summary Financial Statements present fairly, in all material respects, the consolidated financial position of the Province at a point in time (e.g.; March 31, 2016), and the consolidated results of its operations, the change in its net debt, the change in its accumulated deficit, and its cash flows for the year then ended (e.g.; the year ended March 31, 2016) in accordance with Canadian Public Sector Accounting Standards.

Audit procedures are performed to detect material misstatements in the financial statements. Materiality means how significant a financial statement omission or misstatement, either individually or in the aggregate, would need to be in order for such omissions or misstatements to be expected to influence or change the decisions of reasonably knowledgeable users relying on those financial statements. Guidance is provided by GAAS and professional judgment is exercised in order to set an overall level of materiality for the audit.

All errors or misstatements noted during the audit are accumulated and an assessment is made whether they would individually, or in aggregate, cause the financial statements to be materially misstated, based on the level of materiality chosen for the audit or because of other qualitative considerations associated with the information irrespective of the magnitude of the misstatement or omission.

Audit Procedures and Evidence

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Summary Financial Statements. The procedures selected depend on the auditor's judgment, including an assessment of risks of material misstatement of the Consolidated Summary Financial Statements, whether due to fraud or error.

Internal controls relevant to the preparation of the Consolidated Summary Financial Statements are considered in order to design audit procedures, but not for the purpose of expressing an opinion on the effectiveness of Government's system of internal controls.

The audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Government, as well as evaluating the overall presentation of the Consolidated Summary Financial Statements.

Audit Opinion

An unqualified audit opinion was issued on the Consolidated Summary Financial Statements for the year ended March 31, 2016, concluding that they were fairly presented, in all material respects, in accordance with Canadian Public Sector Accounting Standards.

We have not provided an opinion on the effectiveness of internal controls or whether Government exercised its fiduciary responsibilities - these are not the focus of a financial statement audit. If we have suggestions of any means to improve controls or management practices during our audit, we discuss them with Government and communicate these findings in writing to Government. This is consistent with GAAS.

CHAPTER 5

UNDERSTANDING THE CONSOLIDATED SUMMARY FINANCIAL STATEMENTS

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Introduction

The Consolidated Summary Financial Statements present the most comprehensive view of the financial position of the Province as at March 31, 2016. Included with the financial statements, the Department of Finance provides a commentary - *Understanding the Financial Health of the Province of Newfoundland and Labrador*. This commentary is intended to provide readers of the financial statements with additional tools to be able to assess the information contained in the financial statements.

Understanding the Consolidated Summary Financial Statements

While the Budget outlines Government's plan for the coming fiscal year, the Consolidated Summary Financial Statements are the financial report card of the actual results for a fiscal year. The Province's fiscal year runs from April 1 to March 31. The financial statements are a comprehensive document consisting of five individual statements as well as explanatory notes and schedules.

The five individual statements are each designed to provide separate pieces of information that are linked together to present an overall financial picture.

Consolidated Statement of Financial Position

This statement provides a snapshot of the financial position of the Province at a point in time - the end of the fiscal year (e.g.; March 31, 2016). Comparative figures are also shown for the same point in time the previous year. This allows the reader to be able to make comparisons and consider trends related to financial results.

There are five main components that make up the financial position of the Province. Table 1 outlines the components of the Consolidated Statement of Financial Position at March 31, 2016.

Table 1

Consolidated Summary Financial Statements
Components of the Consolidated Statement of Financial Position
As at March 31, 2016
($000s)

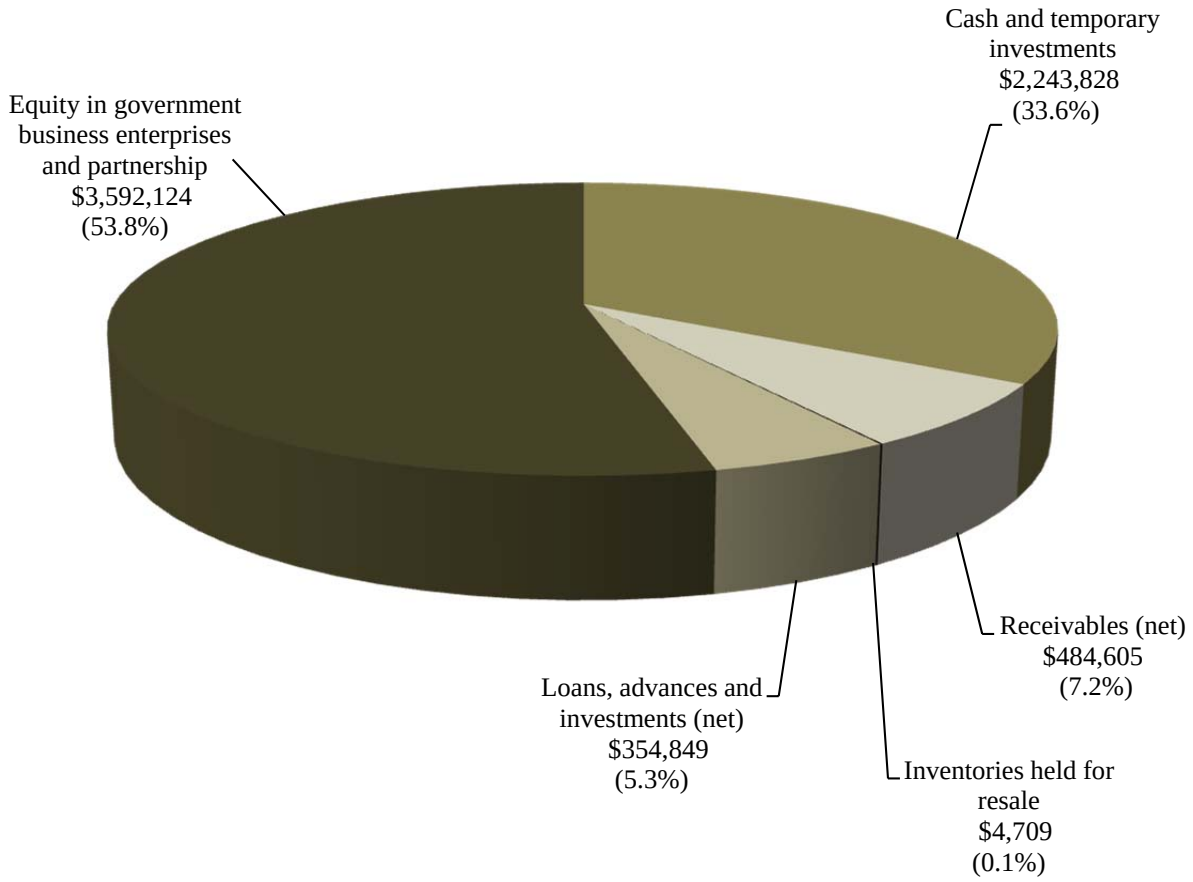
Component	Amount
Financial Assets	$ 6,680,115
Liabilities	19,334,168
Net Debt	**12,654,053**
Non-financial Assets	4,483,893
Accumulated Deficit	**$ 8,170,160**

Financial Assets

Financial assets are those that could be used to discharge existing liabilities or finance future operations. Chart 1 shows the financial assets of the Province for the year ended March 31, 2016.

Chart 1

Consolidated Summary Financial Statements
Financial Assets
As at March 31, 2016
($000s)



Total: $6,680,115

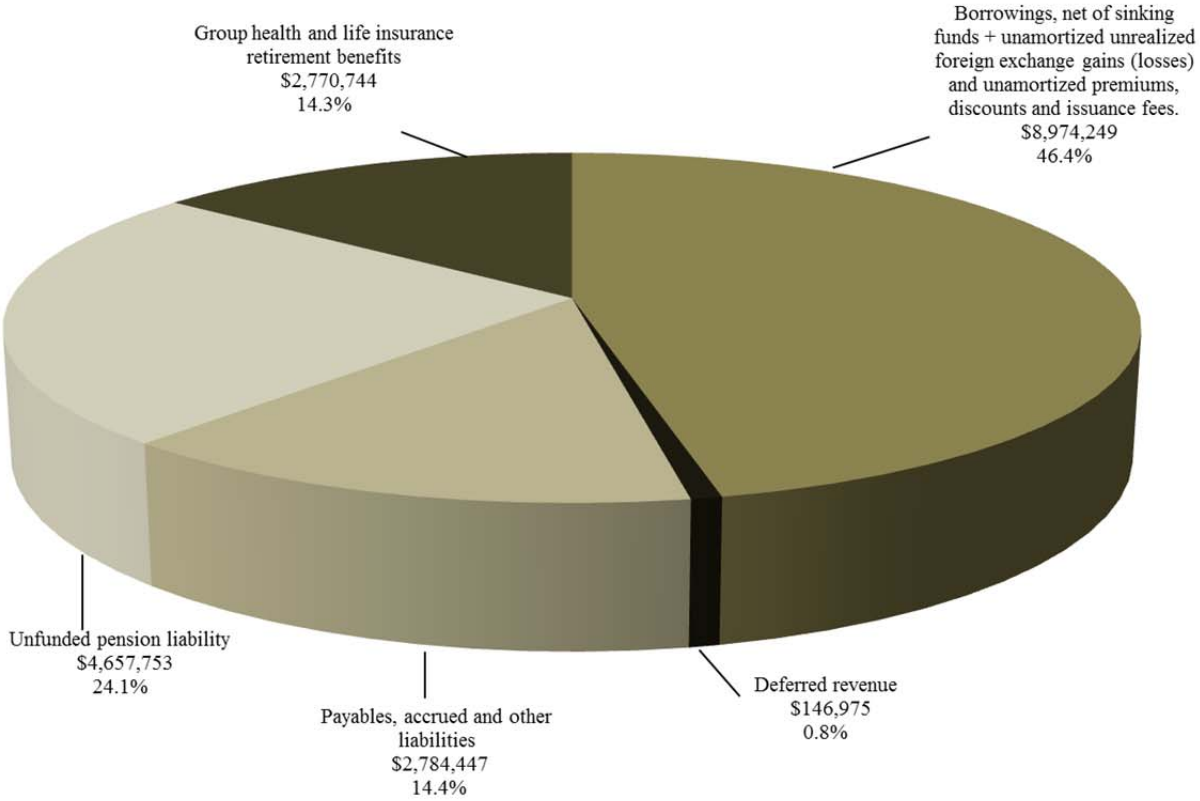
Equity in Government Business Enterprises and partnership reflects the net assets (assets less liabilities) of Nalcor Energy, the Newfoundland and Labrador Liquor Corporation, and Government's 25% equity interest in the Atlantic Lottery Corporation, Inc. This equity is used by these entities to generate a profit each year which accrues to the benefit of the Province.

Liabilities

Liabilities represent amounts that are payable or will be required to be paid to third parties and include amounts payable in the normal course of operations, deferred revenue, amounts due to bond holders and other lenders that have provided money to finance the Province's operations and amounts the Province is responsible for related to employee future benefit obligations. Chart 2 shows the liabilities of the Province as at March 31, 2016.

Chart 2

Consolidated Summary Financial Statements
Liabilities
As at March 31, 2016
($000s)



Total: $19,334,168

Net Debt

Net Debt represents the difference between liabilities and financial assets. This is one of the key measures that is used to evaluate the financial health of all senior governments in Canada.

The Province's Net Debt at March 31, 2016, was $12.7 billion (2015 - $10.3 billion).

Non-financial assets

The most significant non-financial assets are the Province's investment in tangible capital assets. These are, essentially, the physical assets that Government uses to deliver services to the people of the Province.

Tangible capital assets comprise such things as land, buildings, roads, equipment, vehicles and other items which have a useful life extending beyond one year.

Non-financial assets of the Province at March 31, 2016, were:

• Tangible capital assets	$4.38 billion
• Prepaid expenses, deferred charges and inventories	0.10 billion
Total Non-financial Assets	$4.48 billion

Accumulated Deficit

As the name implies, this is the accumulated amount of deficits that the Province has incurred over time less any surpluses.

The accumulated deficit of the Province at March 31, 2016, was $8.2 billion (2015 - $6.0 billion).

Consolidated Statement of Change in Net Debt

This statement provides information on how Net Debt has changed from one year to the next. There are two main elements that impact Net Debt from year to year:

1. Surplus or deficit for the year

   If the Province operates with a surplus for the year, this will reduce Net Debt. Similarly, a deficit will increase Net Debt.

2. Changes in Tangible Capital Assets

   The acquisition of tangible capital assets increases Net Debt each year. This amount is adjusted for the net book value of any disposals of tangible capital assets during the year and by the amount of amortization which is already included in determining the surplus or deficit for the year.

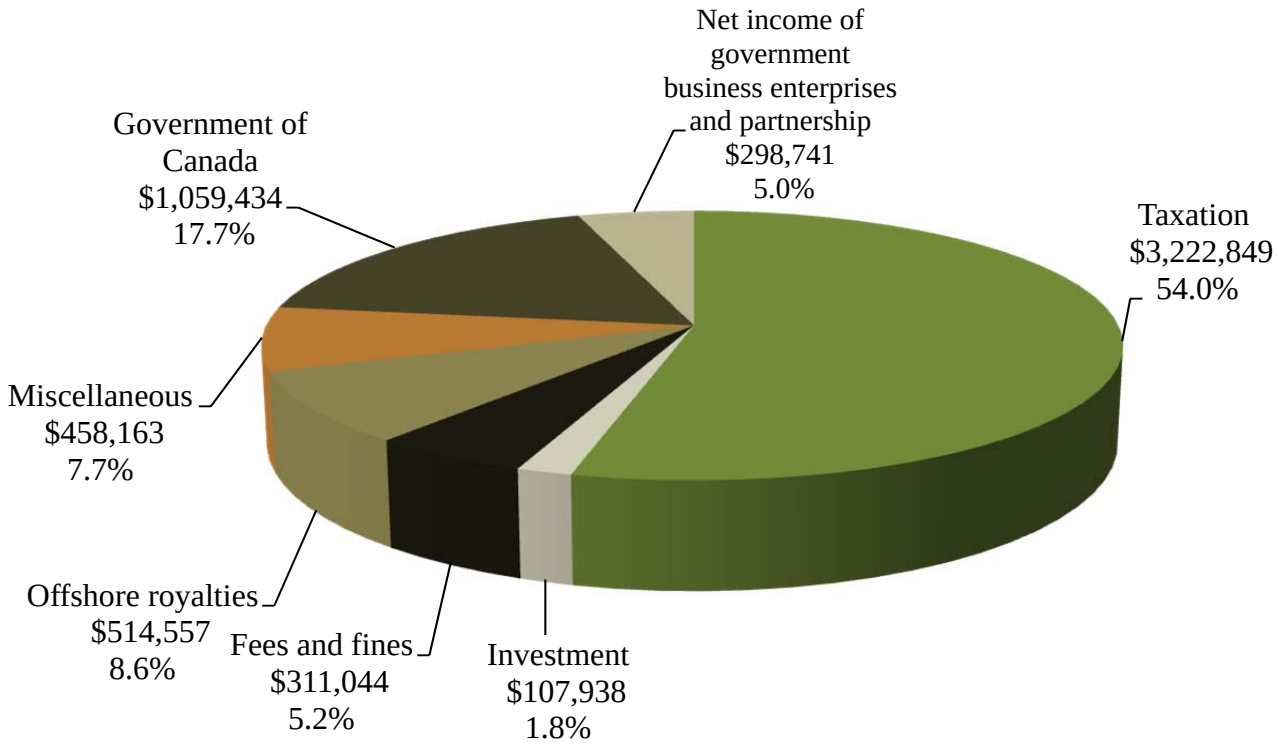
Consolidated Statement of Operations

This statement shows the results of the operations of the Government Reporting Entity for the year April 1, 2015 to March 31, 2016, including the Consolidated Revenue Fund (central Government, Legislature and departments) and the 43 Crown corporations, boards, and authorities that are controlled by the Government of Newfoundland and Labrador. These results are compared to the original estimates that were presented to the Legislature and approved as part of the budget process.

The statement provides the amount of revenue that the Province generated during the year and is broken down by major categories. Chart 3 shows the revenues of the Province by source for the year ended March 31, 2016. Approximately 9% of the Province's total revenues came from offshore royalties.

Chart 3

Consolidated Summary Financial Statements
Revenues by Source
Year Ended March 31, 2016
($000s)

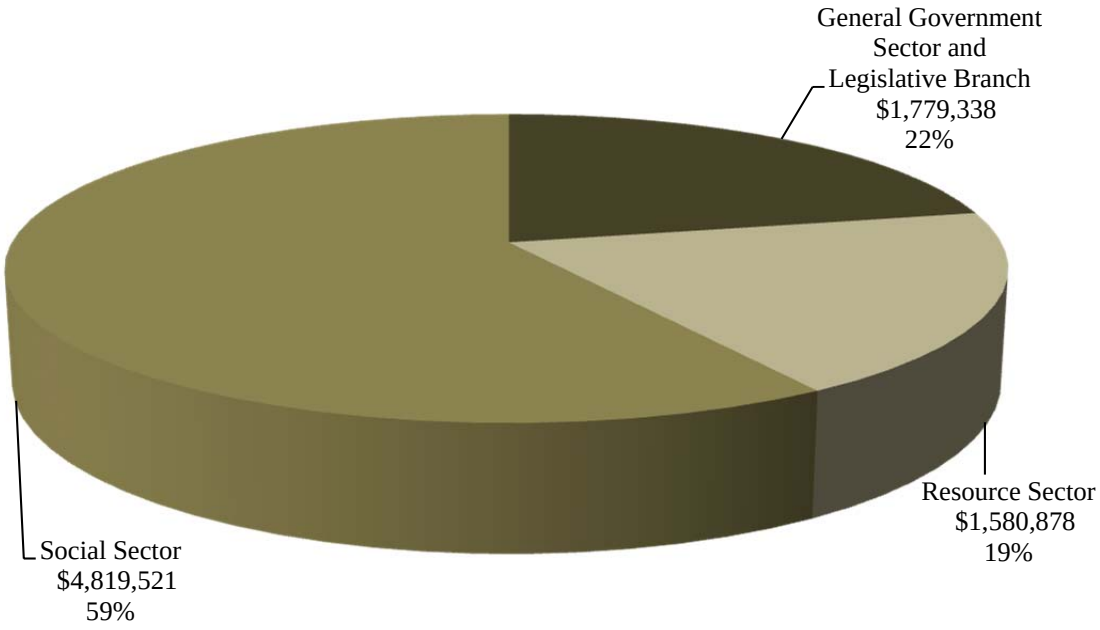


Total: $5,972,726

The statement also provides information on the expenses incurred by the Province during the year by major functional area. Chart 4 shows the expenses of the Province by major functional area for the year ended March 31, 2016. Approximately 59% of the Province's total expenses of $8.2 billion were spent in the social sector.

Chart 4

Consolidated Revenue Fund Financial Statements
Expenses by major functional area
Year Ended March 31, 2016
($000s)



Total: $8,179,737

The difference between revenue and expense for the year is the annual surplus or deficit. When revenue exceeds expenses, a surplus results and, conversely, when expenses exceeds revenue, a deficit is the result.

The Province has recorded a deficit of $2.2 billion for the year ended March 31, 2016 (2015 - $1.0 billion deficit).

Consolidated Statement of Changes in Accumulated Deficit

This statement provides the details of what comprises the change in accumulated deficit for the year. In general, the accumulated deficit is impacted by the annual surplus or deficit.

The accumulated deficit at the end of the fiscal year is also impacted by adjustments to the opening balance of accumulated deficit. For the year ended March 31, 2016, these adjustments primarily resulted from:

- Government organization changes resulting from changes in accounting policies of entities forming part of the Government Reporting Entity and restatements of the financial statements of these entities.

- Changes to entities included in the Government Reporting Entity.

Consolidated Statement of Cash Flows

This statement provides useful information to the reader regarding how cash resources were generated during the year and how they were used. The four main categories that cash is provided from or applied to are:

- Operations
- Capital Transactions
- Financing Activities
- Investing Activities

Notes to the Consolidated Financial Statements and Schedules

The Notes and Schedules provide considerable additional detail and explanation around information contained in the financial statements. The notes are an integral part of the financial statements.

APPENDIX
I
ANSWERS TO FREQUENTLY ASKED QUESTIONS ABOUT THE PUBLIC ACCOUNTS

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What are the Public Accounts?

The Public Accounts contain the annual financial statements of the Province of Newfoundland and Labrador. They are a representation by Government, of the Province's financial condition as at the end of a fiscal year, and the results of its operations, the changes in its Net Debt and its cash flows for the year ended on that date.

The *Financial Administration Act* requires that the Public Accounts show:

- the state of the public debt;
- the revenue and expenditure;
- all compromises, remissions, refunds and amounts written off; and
- those other accounts and statements that may under good accounting practice be required to show the financial position of the Province at the end of the fiscal year.

Why are they prepared?

The *Financial Administration Act* requires that the Public Accounts be prepared and tabled in the House of Assembly. The Public Accounts provide an important link in an essential chain of public accountability. In an era where, in Canada and throughout the world, there is a heightened need for transparency and accountability, the preparation and audit of Government's financial statements is of increasing importance. These statements are the principal means by which Government reports to the House of Assembly and to all Newfoundlanders and Labradorians on its stewardship of public funds.

Public Accounts - Consolidated Summary Financial Statements

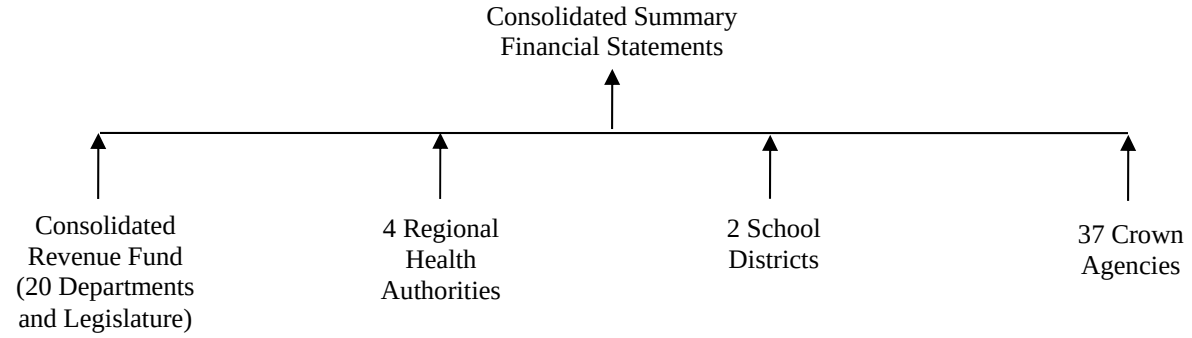
The Public Accounts of the Province of Newfoundland and Labrador for the year ended March 31, 2016, consists of the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador. The Consolidated Summary Financial Statements are prepared on the accrual basis of accounting in accordance with the accounting standards (*i.e.;* Canadian Public Sector Accounting Standards) established for governments by the Public Sector Accounting Board (PSAB) of the Chartered Professional Accountants of Canada, and as outlined in the significant accounting policies of the Province.

Information contained in these financial statements provides the most complete information about the operating results and financial position of the Province and combines the financial activities of the Consolidated Revenue Fund (which accounts for the financial activities of the 20 Government departments and the Legislature) and the various Crown corporations, boards and authorities which are controlled by and therefore accountable to the Government of Newfoundland and Labrador. Government departments and Crown agencies are accountable for the administration of their financial affairs and resources through a Minister.

The types of entities included in these financial statements are outlined as follows:

Chart 1

Entities included in the Consolidated Summary Financial Statements
March 31, 2016



As Chart 1 shows, the Consolidated Summary Financial Statements include the financial activities of the Consolidated Revenue Fund as well as 43 other entities (4 regional health authorities, 2 school districts and 37 Crown agencies).

What Statements are included and what do they show?

Government's financial statements are intended to reflect a fundamental difference between financial reporting for a government and financial reporting for private sector businesses. Governments use public money to provide services through various programs, with no intent to make a profit. As such, a government's financial statements differ from those of business by focusing on Net Debt - not profit or loss. Simply put, Net Debt represents the amount Government will eventually have to raise to pay for incurring past liabilities, and is calculated as total liabilities less total financial assets.

The Consolidated Summary Financial Statements are comprised of five main statements:

Consolidated Statement of Financial Position

This statement shows the Province's financial assets, liabilities, Net Debt, non-financial assets and accumulated deficit.

Financial assets (such as cash, temporary investments and receivables) are different from non-financial assets (such as roads, schools and hospitals) in that they can be used to discharge existing liabilities or finance future operations. Liabilities include borrowings as well as liabilities relating to employee future benefits, including the unfunded pension liability. The difference between liabilities and financial assets is the Province's Net Debt. This is the amount which the government of the day leaves for future governments to either repay or refinance.

Non-financial assets will be used in providing programs and services and therefore are deducted from Net Debt in calculating the accumulated deficit. It is this accumulated deficit which reflects the difference between past expenses and revenues, i.e. the net accumulation of all annual surpluses and deficits.

Consolidated Statement of Change in Net Debt

This statement reflects the change in Net Debt for the year, calculated as the annual surplus or deficit, any changes in the net book value of tangible capital assets, any changes in other non-financial assets, and any changes in net debt resulting from the other comprehensive income or loss of government business enterprises and partnership.

Consolidated Statement of Operations

This statement reflects the annual surplus or deficit, along with a comparison of budgeted and actual revenues and expenses. The surplus or deficit is calculated as the difference between revenues and expenses for the year and represents the extent to which Government was able to raise sufficient revenues to provide for the costs of programs and services, and servicing the debt.

Consolidated Statement of Change in Accumulated Deficit

This statement reflects the change in accumulated deficit primarily resulting from the surplus or deficit for the year.

Consolidated Statement of Cash Flows

This statement reflects the change in cash (and cash equivalents such as temporary investments) and the source and use of cash through operations, financing and investing activities. It also reflects acquisitions and disposals of capital assets.

In addition to the five main statements, there are also several schedules and notes which are an integral part of the statements, and which provide additional disclosure and explanation regarding significant balances, transactions and events during the year.

What accounting policies does Government follow?

The Consolidated Summary Financial Statements are prepared on the accrual basis of accounting in accordance with the accounting standards established for governments by PSAB, and as outlined in the significant accounting policies of the Province. Revenues are recorded when earned with expenses being recorded when incurred, in accordance with the applicable significant accounting policies.

Since PSAB recommendations relating to financial reporting by governments are generally accepted within Canada, section 59 of the *Financial Administration Act (FAA)* requires compliance with these recommendations to properly present the financial position, results of operations and changes in the financial position of the Province at the end of the fiscal year.

The accounting policies used by Government in preparing its financial statements are included in Note 1 to the statements and deal with such things as the method of consolidation and how assets, liabilities, revenues and expenses are recognized. The Province fully complies with PSAB recommendations and standards.

When preparing its financial statements, Government makes significant estimates, as not all information is available or determinable at the time of finalizing the statements. In these cases, estimates are based on the best information available at the time the statements are prepared. Examples of where estimates are used include:

- the recording of revenues related to sales taxes, income taxes, and various transfers from the Government of Canada;

- the accrual of environmental remediation obligations; and

- the accrual of retirement benefits (*e.g.;* Pensions, Group Health and Life Insurance).

As well, estimates have been used in recording some tangible capital assets given that only limited information is available on some older assets. These estimates are audited and are provided for under generally accepted accounting principles.

Who audits the Public Accounts?

The Auditor General is responsible for auditing the financial statements required by the *FAA* to be included in the Public Accounts. Section 11 of the *Auditor General Act* requires that the Auditor General express an opinion as to whether the financial statements present fairly the financial position, results of operations and changes in the financial position of the Province in accordance with Government's disclosed accounting policies and on a basis consistent with that of the preceding year, together with any reservations the Auditor General may have.

Why are they audited?

The House of Assembly is responsible for overseeing the activities of Government and holding Government accountable for its handling of public resources. To assist this process, Government provides information about how it used public resources entrusted to it. One of the main ways Government does this is through the annual preparation, and tabling in the House of Assembly, of the Public Accounts of the Province.

The House of Assembly uses the services of the Auditor General to assist it in carrying out its oversight responsibilities by providing assurance to the Members of the House of Assembly that the information provided in the Public Accounts is appropriate, credible, complete, and accurately reflects the results of the activities of Government.

Consequently, the Auditor General's fundamental role in auditing the Public Accounts is to bring an independent audit and reporting process to bear upon the manner in which the financial statements are prepared and presented.

An audit provides reasonable, but not absolute, assurance that the Province's financial statements are free of material misstatement. Materiality means how significant financial statement omissions or misstatements, either individually or in the aggregate, would need to be in order for such omissions or misstatements to be expected to influence or change the decisions of reasonably knowledgeable users relying on those financial statements. The tolerable level of error or misstatement is a matter of judgment.

It is not possible to provide absolute assurance in a financial statement audit because it is not practical to examine 100% of transactions (due to volume), internal control systems have inherent limitations (due to control override potential), and much audit evidence is persuasive rather than conclusive.

By applying audit procedures to test the accuracy or reasonableness of the figures appearing in the financial statements, we achieve our desired level of assurance. We use audit procedures such as tracing samples of transactions to supporting documents, testing the effectiveness of certain internal controls, confirming year-end balances with third parties and reviewing the reasonableness of estimates.

We also obtain assurance regarding the financial information of Crown agencies which are consolidated in the Province's financial statements, by reviewing the agencies' audited financial statements and, in the case of agencies which are not audited by the Auditor General, by obtaining and reviewing information from the auditors of the agencies.

APPENDIX
II
GLOSSARY

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Accumulated surplus/deficit	This equals the net accumulation of all annual surpluses and deficits experienced by the Province.
Accrual basis	A method of accounting whereby revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is received or paid.
Annual surplus/deficit	The difference between a government's annual revenues and expenses.
CPA Canada	Chartered Professional Accountants of Canada
Consolidated Revenue Fund	All revenues over which the Legislature has power of appropriation form one Consolidated Revenue Fund. This includes the financial operations of Government departments and the Legislature.
Consolidated Summary Financial Statements	Summary financial statements which consolidate the financial statements of the Consolidated Revenue Fund with the financial statements of various Crown Corporations, Boards and Authorities which are controlled by the Government and which form part of the Province's reporting entity.
Debt expenses	Also known as the cost of borrowing, or debt servicing costs, this is the interest cost incurred by a government on its borrowings and liabilities associated with retirement benefits.
Environmental liability	An estimate of the cost of remediation that the Province will have to incur in the future.
Federal transfers	Funds received by a province from the Federal Government, such as the Canada Health and Social Transfer and cost-shared programs.
Financial assets	Assets of a government (such as cash, investments, loans and accounts receivable) that could be used to discharge existing liabilities or finance future operations.
Canadian generally accepted auditing standards	This refers to the auditing standards that auditors, including the Office of the Auditor General, follow in order to be consistent in its auditing practices with similar organizations and to comply with the standards as proclaimed by CPA Canada. The authority for these standards is CPA Canada.
Gross domestic product (GDP)	The money value of goods and services produced within a geographical boundary. It can be reported without adjusting for inflation (known as market value, current or nominal GDP) or it may be discounted for the effects of inflation (real GDP). *In this report, GDP information is obtained from the Department of Finance, unless otherwise indicated, and is not adjusted for inflation, unless otherwise indicated.*

Interest bite	The extent to which a government must use revenue to pay interest costs, rather than to provide new or expanded programs and services, reduce taxation levels or repay debt.
Interest cost	Interest on the Province's debt (e.g. borrowings, unfunded pension liability), as well as other debt-related expenses.
Net borrowings	Total borrowings (debentures, treasury bills, etc.) less sinking funds. Also referred to as Provincial debt.
Net Debt	Government's liabilities less its financial assets. This is the residual liability amount that will have to be paid or financed by future taxpayers.
Non-financial assets	Assets consumed in the delivery of government services, but not intended to reduce existing or future liabilities. Non-financial assets are primarily comprised of tangible capital assets.
PSAB	Public Sector Accounting Board of the Chartered Professional Accountants of Canada. The Board issues standards and guidance with respect to matters of accounting and financial reporting in the public sector.
Public Accounts	Annual financial accountability document of the Province. It consists of the Consolidated Summary Financial Statements.
Public debt	Borrowings of a government. Debt generally consists of debentures, notes payable, capital leases and mortgages.
Tangible capital assets	Non-financial assets which are held for use in the production or supply of goods and services and have useful economic lives extending beyond an accounting period. Examples include buildings, roads, infrastructure, marine vessels and heavy equipment and machinery.