Reflections of the Auditor General

The following comments are made further to my audit of the Public Accounts of the Province for the year ended 31 March 2006. The Report provides additional information on the financial condition of Government measured by using indicators issued by the Canadian Institute of Chartered Accountants. The Report also offers comments on Government's compliance with generally accepted accounting principles and adherence to principles of sound financial accountability.

Financial Condition of the Province ***(Part 3.3)***

There is a sense of optimism about the potential prosperity of the Province and its ability to improve its financial condition. In large part, this prosperity is derived from oil revenues and the resulting economic impact on the Provincial economy and Provincial revenues.

However, we must not lose sight of the Province's enormous debt, related debt expenses and the fact that oil is a non-renewable resource with a limited life. Furthermore, there is volatility with regards to production levels and world oil prices, both outside the control of Government, which can cause significant changes in fiscal performance.

Reality of Current Financial Condition has to be Considered

To put the financial condition in perspective relative to other provincial jurisdictions I report that, at 31 March 2006, the Province had:

- a net debt of $11.7 billion which results in:

  - the highest net debt per capita of any province in Canada - approximately $23,000 for each Newfoundlander and Labradorian;
  - the highest net debt as a percentage of GDP of any province in Canada at 54.4%; and
  - being included in the lowest credit rating category of any province in Canada.

- debt expenses totalling $947 million which results in:

  - the highest interest costs as a percentage of total revenue of any province in Canada at 17%; and
  - fewer resources to allocate to programs and services as a result of the “interest bite”.

The Annual Surplus (Deficit)

In 2006 the Province recorded a surplus of $199 million, the first annual surplus since 1998. However, consider the following:

- the Province would require a surplus of $300 million each year for 40 years to eliminate its existing net debt, i.e. to be debt free.
- oil revenues are highly volatile to changes in oil prices and oil production. To illustrate this volatility, Government's projected surplus of $6 million for 2006-07 was revised in November 2006 to a deficit of $40 million. The change in economic outlook resulted for the most part from oil production issues outside of Government's control.
- the Province remains heavily reliant on transfers from the Federal government to help pay for the costs of such programs as health, education, and social services - $1.9 billion or 34% of total revenue for 2006 resulted from Federal transfers.
- health and education expenses are increasing and for 2006 amounted to $3.0 billion or over 57% of total expenses in 2006, an increase of $1.0 billion or 50% over the $2.0 billion total expenses in 2001.

In addition to these factors, there are others which could result in changes to the annual surplus or deficit, including an aging infrastructure, an aging population, out-migration, interest and currency rate fluctuations, changes in GDP, and demand for Government programs and services.

Long-term Debt Reduction Planning Essential

Because of the annual recurring theme of deficits in the Province, there has been much discussion and focus on deficit reduction and elimination. However, the Province still has billions of dollars in debt along with the resulting significant interest bite. Continued annual surpluses and a reasoned plan of debt reduction will be required if progress is to be made in eliminating this debt.

As debt decreases debt expenses will reduce, leading to a lower interest bite and more funding available for Government programs. For example, in March 2006, Government paid $1.953 billion from the proceeds of the Atlantic Accord (2005) agreement to reduce the unfunded liability of the Teachers' Pension Plan. This will result in significant debt expense reductions in the future.

It is encouraging that Government has made progress regarding the annual deficits. However, given the preceding financial indicators, prudent fiscal management has to continue and a debt reduction plan has to be developed and followed before the financial condition of the Province is turned around.

I will, on behalf of all Members of the House of Assembly, continue to monitor Government's fiscal performance and report annually as to whether progress is being made to bring the Province's finances in order.

Pensions ***(Part 4.1)***

While the Province's unfunded pension liability as at 31 March 2006 of $2.201 billion decreased significantly from $3.934 billion as at 31 March 2005, it continues to represent a significant debt for Government. The main reason for the $1.733 billion decrease was the decision by Government to use $1.953 billion of the proceeds from the Atlantic Accord (2005) agreement to reduce the unfunded pension liability of the Teachers' Pension Plan.

I note that, although there was a reduction in the Province's overall unfunded pension liability, the unfunded pension liability for three of the Province's five plans (Public Service Pension Plan, Members of the House of Assembly Pension Plan, Provincial Court Judges' Pension Plan) increased by $97 million during the year.

Although interest costs in future years should decrease as a result of the reduction in the overall unfunded pension liability, addressing the liability should remain a priority for Government.

Group Health and Group Life Retirement Benefits ***(Part 4.2)***

The liability for group health and group life insurance retirement benefits has added to the already considerable debt load of the Province and is expected to increase in each of the next four years. The net liability as at 31 March 2006 was $1.265 billion (2005 - $1.159 billion). By 2010 the net liability is expected to total $1.607 billion if action is not taken to address it, an increase of $622 million or 63% since it was first recorded in 2003.

Government should carefully manage its liability relating to group health and group life insurance retirement benefits.

Internal Audit ***(Part 5.3)***

Internal audit in Government is not sufficiently resourced to adequately perform the duties expected of a modern and effective internal audit function. In recent years, standards of practice for internal auditing have prescribed increased duties and responsibilities for the internal audit function in such areas as accountability, governance, risk management and assurance. Internal audit within Government is currently comprised of only 3 positions - in 1991 there were 21 positions.

An internal audit function is an integral part of an effective internal control system which would help prevent or detect instances of: public money not being appropriately collected and disbursed; non-compliance with legislation and/or Government policies; lack of safeguarding and accounting for the Province's assets; and weaknesses in accounting and management control systems.

The lack of internal control and management safeguards at the House of Assembly establishment which led to excess claims and questionable payments to companies highlights the importance of independent scrutiny. An effective internal audit function can help ensure that preventative and detective controls are implemented and functioning.

Government should ensure its internal audit function is sufficiently resourced.

Environmental Liabilities ***(Part 5.6)***

Although Government has started to capture information on contaminated sites, there is still no complete central inventory of such sites in the Province. Furthermore, although the Province's environmental liability relating to remediation costs for contaminated sites may be a significant amount, only $10.7 million has been recorded as a liability in the Province's financial statements. I note that a report made public by Government in January 2004 referred to an estimated cost of $237 million relating to the remediation of contaminated sites.

Government should be more proactive in identifying all contaminated sites in the Province for which it is potentially liable, determining the estimated liability associated with remediation costs, and recording the resulting liability in the Province's financial statements.

Transparency and Accountability Act ***(Part 5.2)***

On 29 November 2004, Government tabled the *Transparency and Accountability Act* which received Royal Assent on 16 December 2004. However, nearly two years later, the *Act* has still not been proclaimed and, therefore, is not in force.

Although Government has been diligent in having annual reports tabled for departments and Crown agencies, the reports provide only general information on the operations of the department or agency. The reports do not provide the information necessary to hold each entity accountable for its performance, including fiscal performance, in relation to its approved plans, using established measurable criteria. As well, there has been little progress in tabling strategic, business or activity plans in the House of Assembly.

The *Transparency and Accountability Act* should be proclaimed. Furthermore, Government should address the lack of plans being tabled in the House of Assembly and require that appropriate accountability information be included in annual reports tabled in the House of Assembly.

Acknowledgements

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

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Auditor General

Reflections of the Auditor General