



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, 2015**

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.

VISION

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

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**AUDITOR
GENERAL**
of Newfoundland and Labrador

January 29, 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 for the year ended March 31, 2015.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Terry Paddon', with a long horizontal line extending to the right.

TERRY PADDON, CPA, CA
Auditor General

Table of Contents

Chapter		Page
1	Introduction	
	• Introduction	1
	• Overview	1
	• Changes to Employee Retirement Benefits	2
	• Reports Issued Pursuant to Section 15(1) of the <i>Auditor General Act</i>	3
2	Summary of Observations	7
3	The Financial Condition of the Province	
	• Consolidated Summary Financial Statements	15
	• Economic Outlook	17
	• Deficits	22
	• Net Debt	28
	• Revenues	35
	• Expenses	42
	• Dealing with the Deficit	51
4	Financial Accountability	
	• Background	53
	• Legislative Requirements	53
	• Consolidated Summary Financial Statements	53
	• Responsibility for the Public Accounts	56
	• Independent Auditor's Report	56

Table of Contents

Chapter		Page
5	Understanding the Consolidated Summary Financial Statements	
	• Introduction	59
	• Understanding the Consolidated Summary Financial Statements	59
Appendices		
I	Answers to Frequently Asked Questions about the Public Accounts	67
II	Glossary	73

**CHAPTER
1
INTRODUCTION**

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, 2015, and comments on the risks and challenges the Province faces considering the information provided in Budget 2015 and the additional information contained in the Fiscal Update provided in December 2015.

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

Overview

The Consolidated Summary Financial Statements for the year ended March 31, 2015, shows a deficit for the year of \$986 million, the largest in the Province's history, and Net Debt amounting to \$10.3 billion.

Fiscal Recovery Plan

Budget 2015 contained a Fiscal Recovery Plan which was intended to guide the Province's return to surplus by 2019-20. The Plan relied on increasing oil production, increasing oil prices, increased economic activity and two explicit policy actions –an employee attrition plan and tax increases. The attrition plan was the only policy action designed to reduce expenses over the period of the Recovery Plan and was expected to have an annual impact, when fully implemented, of \$100 million. The primary tax increase, a 2 percentage point increase in the HST, has been cancelled.

Revised Fiscal Outlook

The Economic and Fiscal Update released by the Province in December 2015 forecasts an extended period of unprecedented deficits. This forecast is based on assumptions of economic growth, increasing oil production, increasing oil prices and other revenue and expense growth, all of which contain various elements of risk as to whether they are achievable.

- Economic growth will largely be impacted by the resource sector in Newfoundland and Labrador and this will be dependent on global expectations. This is beyond the control of the Province.
- Oil production is, again, largely beyond the control of the Province and cannot be greatly influenced in order to manage future deficits.
- Oil price, another significant and volatile factor affecting the Province's financial performance, is also beyond the control of the Province.

- Other revenue, including income and consumption taxes, are within the control of the Province to manage. Tax base and rate changes can be made to increase revenue, however, Government will have to consider a balance between revenue generation and ensuring a reasonably competitive tax system.
- Program expenses are the area over which the Province has the most control. Government will have to balance need with affordability and consider how and where programs and services are delivered. Given the expected revenue levels over the next six years, program expenses would have to reduce to 2010 levels in order to approach a balanced budget in the absence of revenue measures.

The Province will have to consider all these elements as it develops a strategy to significantly reduce the potential deficits and also consider the timeframe in which to implement the strategy.

Changes to Employee Retirement Benefits

In September 2014, Government and unions representing employees of the Public Service Pension Plan (PSPP) reached an agreement designed to address the sustainability of the PSPP. Government will pay \$2.7 billion, amortized over 30 years, to address the estimated unfunded liability of the PSPP at the date of the agreement. The unions have agreed to plan changes and increases in contribution rates. The agreement also provides for joint trusteeship, which means that both Government and unions are responsible for the future sustainability of the PSPP and will share equally in measures to deal with any of the PSPP's future surpluses and deficits. The Trustee, who will oversee the administration of the PSPP, will be an independent corporation. Legislation establishing the framework for the joint trusteeship was passed by the House of Assembly in December 2014. The plan changes and increases in contribution rates became effective on January 1, 2015.

The agreement and legislation provides a framework for managing the PSPP in the future.

The impact of these changes to the PSPP is reflected in the Consolidated Summary Financial Statements.

Changes have also been made to other employee future benefits provided by Government. New employees and employees who do not meet existing eligibility requirements during a five year transition period, will now have to be eligible to receive a pension and have a minimum of 10 years of service to receive group health and group life insurance retirement benefits. Previously, employees had to be eligible to receive a pension, or could leave the employ of the Province and defer receiving a pension, and have a minimum of 5 years of service to receive these benefits.

Subsequent to March 31, 2015, an agreement was also reached between the Government and the Newfoundland and Labrador Teachers' Association which provides for changes the Teachers' Pension Plan. These changes will be reflected in subsequent financial statements.

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, 2015, my Office became aware of the following:

- The Professional Services and Internal Audit Division (the Division) of the Department of Finance informed my Office that during an examination of the Provincial Courts bank reconciliation processes by the Division, potential fraud was discovered. Deposits of approximately \$42,000 (less approximately \$4,300 which appears to have been repaid) were allegedly stolen from the Provincial Court. The Department of Justice and Public Safety has referred this matter to the police for investigation. The Department of Justice and Public Safety also reported this matter to my Office. I reported this matter to the Minister of Finance on January 8, 2016.
- The Division reported to my Office that they were informed by the Department of Transportation and Works of a suspected fraud at a depot. The suspected fraud involved thefts of automotive fuel and supplies as well as inappropriate use of employee resources. It was concluded by the Division that due to the poor state of records and lack of effective internal controls at the depot, it was not possible to prove that any fraud had occurred. No further action was taken. I reported this matter to the Minister of Finance on January 8, 2016.
- The Department of Justice and Public Safety informed my Office that during a routine review of travel claims, irregularities were identified which totaled approximately \$1,300. The Department indicated that the matter has been forwarded to the police for investigation. I reported this matter to the Minister of Finance on January 8, 2016.
- The Department of Child, Youth and Family Services informed my Office of one instance of suspected fraud related to payments for client services. They identified that a foster parent may have committed fraud by submitting claims for funding for overnight babysitting when no babysitting services were provided. A report was forwarded to the police on February 16, 2015. There has been no estimation of the amount of fraud. The individual is no longer a foster parent. I reported this matter to the Minister of Finance on January 8, 2016.

Introduction

- The Department of Advanced Education and Skills informed my Office of two instances of alleged client fraud, which I reported to the Minister of Finance on January 8, 2016:
 - An alleged forgery of documentation submitted for reimbursement of medical transportation costs of approximately \$30,000 was referred to the Department's Eligibility Assurance Unit on December 9, 2014, and forwarded to the police for formal investigation on May 8, 2015.
 - An investigation into possible false documentation to support rental payments of approximately \$27,000 was conducted by the Eligibility Assurance Unit in March 2015. The results of the investigation were submitted to the police on May 29, 2015.
- The Forestry and Agrifoods Agency (the Agency) informed my Office of one instance of alleged misappropriation of funds by an employee of the Agency. The employee misappropriated the funds by deliberately delaying the submission of cash remittances and personally using the funds during the intervening period. The misappropriation occurred on numerous occasions over a period of time with an estimated total value of \$21,000. The Agency indicated that all funds were eventually reconciled and deposited and no funds were left unaccounted for. This matter was not reported to the police as all funds were returned without incident. The employee involved was terminated. I reported this matter to the Minister of Finance on January 14, 2016.

As part of the audit of the Public Accounts, my Office reviewed the audit working papers of significant Crown entities for which I am not the auditor.

- During the review of the audit working papers related to the audit of Nalcor Energy for the year ended December 31, 2014, it was noted that Nalcor Energy identified a theft of petty cash of \$360. In response, Nalcor Energy's Internal Audit personnel provided the Audit Committee with suggestions to improve controls over petty cash. I reported this matter to the Minister of Finance on January 8, 2016.

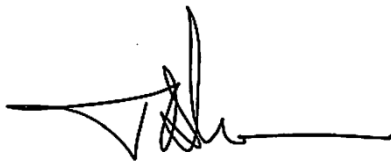
As part of our audit of the financial statements of two Crown entities, my Office became aware of the following:

- During the audit of the Provincial Information and Library Resources Board (the Board) for the year ended March 31, 2015, my Office was informed of a fraud against the Board. In April 2015, as part of its bank reconciliation process, the Board identified a cheque totaling \$7,100 that cleared its bank that was not a legitimate cheque. It was determined that a third party, outside of the Board, had gained access to a cheque that had previously cleared the Board's bank account and altered the cheque. The altered cheque was deposited by the third party using an application that permits cheques to be deposited into an account by using a picture of the cheque. The Board subsequently recovered the \$7,100 from its bank. The incident was not reported to the police. I reported this matter to the Minister of Finance on January 8, 2016.

- During the audit of the Newfoundland and Labrador Housing Corporation (the Corporation) for the year ended March 31, 2015, my Office was informed of an instance of improper retention of public money. The Corporation determined that two employees were using their assigned corporate procurement cards to make purchases for personal use. The Corporation's policy prohibits the use of Corporation procurement cards for personal transactions. Overall, the improper transactions amounted to \$5,156 (\$4,698 related to one employee and \$458 to another). The \$5,156 has been recovered from both employees and one employee has resigned. The other remains an employee of the Corporation. The Corporation has not referred the matter to the police. I reported this matter to the Minister of Finance on July 23, 2015.

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

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CHAPTER

2

SUMMARY OF OBSERVATIONS

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. Given the significant deterioration of the Province's financial outlook since March 31, 2015, the Consolidated Summary Financial Statements must be read in conjunction with subsequent financial information released by the Province and other publically available information in order to gain a clearer understanding of the Province's current financial circumstances.

Overview

2. The Province is expecting substantial deficits to persist until 2020-21 and, likely, beyond.
3. 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.

Economic Outlook

Gross Domestic Product

4. 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.
5. Nominal GDP is forecast by the Province to steadily increase from 2016 to 2020 based on assumed:
 - increases in oil production and prices;
 - production from the Voisey's Bay underground mine;
 - hydroelectric production from Muskrat Falls; and
 - development of the Bay du Nord oil field.
6. In the absence of a development agreement and the current low oil price environment, there is considerable risk that expected activity from the Bay du Nord development will not occur in the forecast period.

Capital Investment

7. Capital investment is expected to decline significantly in 2016, 2017 and 2018 which will have a corresponding negative impact on employment and revenue to the treasury.

8. The Province is forecasting that capital investment will rise in 2019 and 2020 based on the assumption that development of the Bay du Nord oil field will commence. There is no certainty that this will occur by 2019.

Employment

9. Employment is forecast to rise in 2019 and 2020, presumably on the strength of the Province's expectation that development of the Bay du Nord will commence at that time. Uncertainty around the timing of this development presents a risk to this expected increase in employment.

Deficits

2014-15

10. The actual deficit recorded by the Province for the year ended March 31, 2015 was \$986 million - 2 ½ times greater than the deficit recorded in the previous year and a \$448 million deterioration from the amount predicted in Budget 2014.
11. The deficit of \$986 million recorded in 2014-15 is the highest ever recorded by the Province.
12. The Province has accumulated deficits in excess of \$1.5 billion over the last three fiscal years.
13. Budget 2014 provided for an increase in total expenses of \$398 million in 2014-15, a 5% increase over the previous year, in a year the Province was budgeting for a deficit of \$538 million.

Projected Deficits 2015-16 to 2020-21

2015-16

14. The Province is now expecting a deficit of \$2.0 billion for 2015-16, triggered by a decline in revenue of \$888 million, which is still subject to considerable risk given the continued weakness of commodity markets.
15. Reductions in the price of oil and oil production from the amounts originally forecast in Budget 2015 exacerbate a budget deficit starting position that was already at \$1.1 billion.
16. Expenses for 2015-16, which had been budgeted to be \$8.1 billion, are expected to be \$18 million below the original target – a reduction of 0.2%.
17. Budgets 2014 and 2015, combined, provided for increases in expenses of \$558 million in years where budgeted deficits were forecast to total \$1.6 billion.

Summary of Observations

2016-17 to 2020-21

18. Projected deficits for the years 2016-17 to 2020-21 are now forecast to total \$10.2 billion - an amount almost equivalent to the Province's total Net Debt at March 31, 2015. Given the current uncertainty regarding the future of commodity prices, the Province cannot support this level of accumulated deficit.
19. Even if expenses remained at the 2015-16 level for the next five years, the Province would still be facing a deficit of over \$900 million in 2020-21.
20. Given that the current forecast is based on an assumption of steadily increasing oil prices up to 2020-21, there is risk that the forecast revenue growth may not be achieved. The Province did not meet its budgeted revenue target in 2014-15 and is not expected to meet its target in 2015-16.

Deficit as a Percentage of GDP

2014-15 and 2015-16

21. Newfoundland and Labrador's deficit as a percentage of GDP for 2014-15 is 2.9% - over 2 times greater than the next highest province.
22. The forecast deficit as a percentage of GDP for 2015-16 is expected to increase substantially to 6.5% - approximately 3½ times greater than the next highest province.

2015-16 to 2020-21

23. Throughout the forecast period, the Province is facing deficits that, in relation to the size of the economy, will be up to 13 times higher than the average of all the other provinces, well beyond what would be considered reasonable and sustainable.

Net Debt

2014-15

24. Net Debt of the Province at March 31, 2015 was \$10.3 billion, an increase of \$1.2 billion from the previous year.
25. At March 31, 2015, Net Debt had increased by approximately \$2.5 billion from its low point in 2011-12 primarily the result of deficits totaling \$1.6 billion in the 2012-13 through 2014-15 fiscal years plus the impact of tangible capital asset acquisitions during this period.

Tangible Capital Assets (Infrastructure)

26. Since the infrastructure spending initiative which was designed to support the economy from 2010 to 2012 after the recession, the Province's annual spending on infrastructure has averaged \$547 million – more than double the pre-recession levels.

Summary of Observations

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

2015-16 to 2020-21

28. The Province's Net Debt is forecast to increase to \$12.4 billion by March 31, 2016, the highest level of Net Debt in the Province's history.
29. Deficits, totaling in excess of \$12 billion, combined with spending on infrastructure from 2015-16 to 2020-21 are expected to increase Net Debt by an additional \$12.6 billion to an all-time high of \$22.9 billion by March 31, 2021, and more than double the current level.
30. Over the period 2015-16 to 2020-21, the Province expects to borrow \$15.4 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; and,
 - meet the Province's equity commitment to the Muskrat Falls project plus any required contingent equity to support any cost overruns on the project.
31. This level of Net Debt and borrowing is not affordable for the people of the Province and is not sustainable. It is uncertain, even, whether the capital markets would support this level of borrowing by Newfoundland and Labrador given the current financial outlook.

Net Debt Per Capita

32. By March 31, 2021, Net Debt per capita is expected to reach \$43,603 – almost double the previous high level of \$22,980 at March 31, 2005. This would represent a significant financial burden for each and every Newfoundlander and Labradorian.

Net Debt as a Percentage of GDP

33. The absolute level of Net Debt and the ratio of Net Debt to GDP at March 31, 2015 would ordinarily be considered reasonable and sustainable, however, when combined with the current forecast over the next six years, the outlook is worrisome.
34. Without action by the Province to slow the growth of Net Debt, the ratio of Net Debt to GDP is forecast to grow to 64.2% by March 31, 2021 – the highest level in the Province's history.

Revenues

35. For the year ended March 31, 2015, total revenue was \$1.4 billion below the peak achieved in 2011-12.
36. For 2015-16, oil royalties are forecast to decline significantly from \$1.6 billion in 2014-15 to \$552 million, a decline of \$1 billion in just one year.
37. The Province is forecasting revenue to grow by \$1.1 billion over the five year period to 2020-21. This growth in revenue is dependent on the Province achieving the economic growth that it has forecast and the levels of oil production and oil price outlined in the December 2015 Economic and Fiscal Update. Considerable risk surrounds the Province being able to achieve these targets.

Oil Royalties

38. Oil royalties in 2014-15 were \$1.6 billion, a drop of \$1.2 billion from the peak of \$2.8 billion in 2011-12.
39. In 2015-16, oil royalties are expected to account for just 9.1% of revenue, a significant drop in four years from the peak of 33.8% in 2011-12.

Oil Production

2015-16

40. Annual production of offshore oil has shown a downward trend since 2007-08.
41. There is considerable risk that the revised oil production target for 2015-16 will not be met and there is also risk that the forecast 2016-17 production levels may be optimistic. This could negatively affect the deficit outlook for these years.

Oil Price

2014-15

42. 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 2014-15, the price of Brent crude averaged \$US85.46 per barrel.

2015-16

43. In December 2015, the Province revised down its oil price forecast for 2015-16 from \$US62 per barrel to an average of \$US48 per barrel. In order to meet this target, oil prices will need to average \$US36.67 per barrel in January, February and March 2016. The average price, to date, in January 2016 is \$US33.52. While this target is potentially achievable, there is some risk associated with the forecast.

2016-17 to 2020-21

44. The Province is forecasting the price of Brent crude to average \$US48 in 2015-16 and expects to see steady annual increases to \$US73 per barrel by 2020-21. The farther in the future the forecast goes, the greater the risk around predicting oil prices at that time. Even at an average Brent crude price of \$US85 per barrel, the Province recorded a deficit of \$986 million in 2014-15.

Expenses

Program Expenses

45. Total expenses have grown from \$5.4 billion in 2005-06 to \$7.9 billion in 2014-15, an increase of \$2.5 billion or 46%.
46. Program expenses have grown by 62.0% over the ten year period from 2005-06 to 2014-15.
47. Program expenses are forecast to increase by \$580 million from 2014-15 to 2020-21, an average growth rate of 1.3%. This level of expense increase approximates the expected rate of inflation and, in essence, would not provide for any growth in program initiatives.
48. A \$2 billion deficit is still anticipated in 2020-21 despite a forecast of modest expense growth.

Program Expenses by Department

49. Almost 70% of program expenses are directed to the health, education and skills development sectors.
50. Given that the nature of Government program expenses relate to social need, it is difficult to significantly adjust the level of expenses in a short time frame.

Program Expenses by Category

51. In 2014-15, the Province spent \$3.6 billion on salaries and employee benefits which represents 50% of the total program spending of Government.

Attrition Plan

52. The Attrition Plan, currently targeting to reduce the workforce by approximately 3.0%, or 1,420 persons, will not be enough to achieve the expense reductions necessary to significantly reduce the deficit.

Interest costs

53. Interest expense totaled \$772 million in 2014-15 and is forecast to increase to almost \$1.4 billion annually by 2020-21, the result of borrowing to finance deficits in those years and for other purposes. This means an additional \$600 million annually will have to be allocated to service the Provinces debt if action is not taken to reduce forecast annual deficits.
54. Money allocated to servicing debt is money that is not available to fund programs and services.
55. By 2020-21, almost 20% of every dollar of revenue generated is forecast to be allocated to interest expense.

Dealing with the Deficit

56. A forecast which considers a variety of scenarios around growth and expected changes in commodity prices will be a critical element in taking the first step to decision making. This will form the basis for determining medium term deficit targets and a realistic timeframe to achieve those targets and ultimately return to a balanced budget.
57. Increases to personal income tax and the HST, along with other consumption taxes, such as gasoline tax, and corporate income taxes, will have to be considered as part of a balanced package to achieve Government's deficit reduction objective.
58. Given the magnitude of the forecast deficits, any meaningful reductions in spending will, of necessity, have to consider reductions throughout the entire breadth of Government services, including health, education and skills development.
59. Considering that 50% of program expenses are related to human resources, reductions to the Government workforce will be necessary to achieve significant expense reductions.

Consequences of Inaction

60. Inaction could result in increased borrowing costs and restricted access to capital markets.

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**CHAPTER
3
THE FINANCIAL CONDITION
OF THE PROVINCE**

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, 2015, 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 clearer picture of the financial condition of the Province.

Observation

1. Given the significant deterioration of the Province's financial outlook since March 31, 2015, the Consolidated Summary Financial Statements must be read in conjunction with subsequent financial information released by the Province and other publically available information in order to gain a clearer understanding of the Province's current financial circumstances.

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 2011 to 2013, the price of Brent crude averaged approximately \$US110 per barrel. In 2015, Brent crude had declined to an average of \$US52 per barrel and by January 2016 prices had fallen as low as \$US27.36 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 2011-12 to 2013-14, oil royalties accounted for almost 30% of revenues. By 2014-15 this had dropped to 23% and for 2015-16 the Province is projecting that oil royalties will only make up 9% of government revenue.

This drop in oil royalties is contributing to significant deficits which are expected to persist, at least until 2020-21 and, likely, beyond.

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

2. The Province is expecting substantial deficits to persist until 2020-21 and, likely, beyond.
3. 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.

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 2015-16 to 2020-21 obtained from the December 2015 Fiscal and Economic Update and other publically available information.

Economic Outlook

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

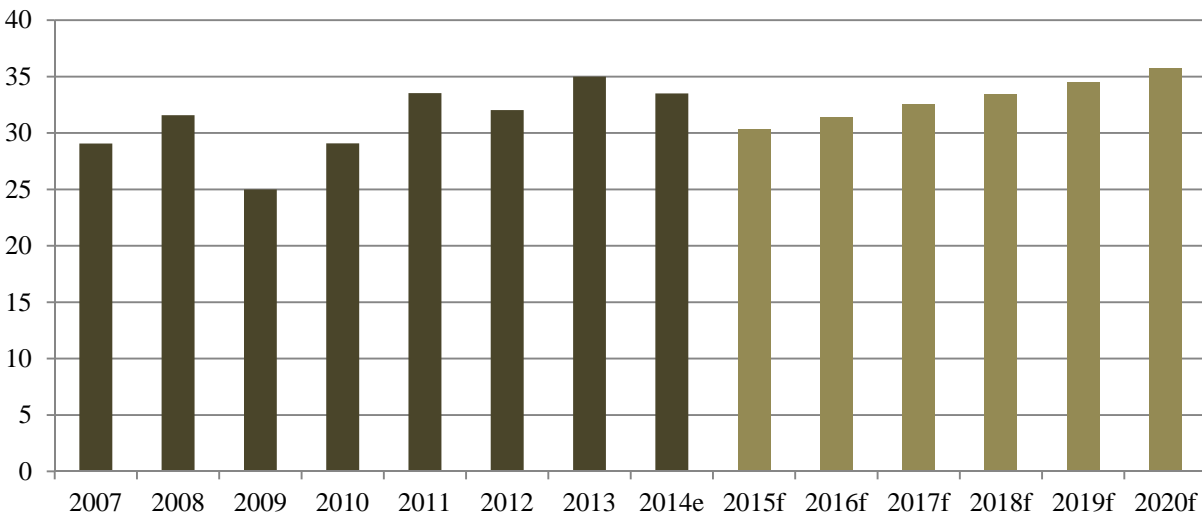
Gross Domestic Product

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 is considered 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 1

Province of Newfoundland and Labrador Nominal GDP (\$ Billions)



Source: Department of Finance

Nominal GDP has experienced considerable fluctuation and volatility since 2007. Most notably during the recession of 2009, GDP was primarily impacted by declines in commodity prices, and in 2015, when GDP was 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, as well as production from the underground mine at Voisey's Bay and hydroelectric production from Muskrat Falls. The 2015 Economic Review, released with the December 2015 Economic and Fiscal Update, also indicates that beyond 2018 "*...development of other offshore resources, such as Statoil's Bay du Nord discovery, are expected to provide a boost to the province's economy.*". Given the lack of an agreement to develop Bay du Nord, there is considerable risk associated with this element of the forecast.

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.

Observations

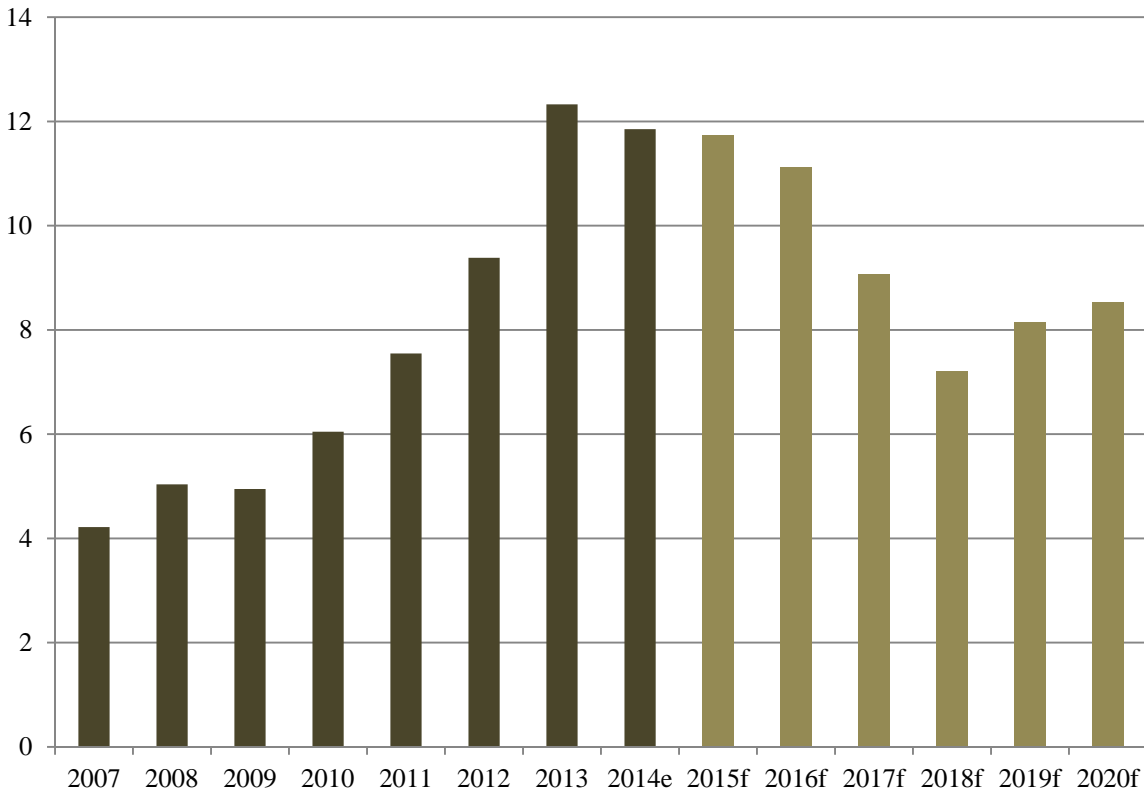
4. The Province's economic forecast is based on assumptions and future expectations and, like any forecast, is subject to considerable risk and change. Given that the economic forecast provides the basis for predicting taxation and other provincial revenues, this risk also extends to the Province's revenue forecast.
5. Nominal GDP is forecast by the Province to steadily increase from 2016 to 2020 based on assumed:
 - increases in oil production and prices;
 - production from the Voisey's Bay underground mine;
 - hydroelectric production from Muskrat Falls; and
 - development of the Bay du Nord oil field.
6. In the absence of a development agreement and the current low oil price environment, there is considerable risk that expected activity from the Bay du Nord development will not occur in the forecast period.

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.

Chart 2

Province of Newfoundland and Labrador Capital Investment (\$ Billions)



Source: Department of Finance

The Province is forecasting significant declines in the level of capital investment in 2016, 2017 and 2018 as the construction phases of the Hebron and Muskrat Falls developments come to a conclusion. This decline in activity will have a corresponding drop in employment and will impact revenue to the treasury from tax sources such as personal income tax and consumption taxes such as the HST.

The Province is predicting that the level of capital investment will rise in 2019 and 2020 based on the assumption that development of the Bay du Nord oil field will commence. There is no certainty that this will occur by 2019 which could challenge the Province to generate the level of revenue expected in 2019-20 and 2020-21.

Observations

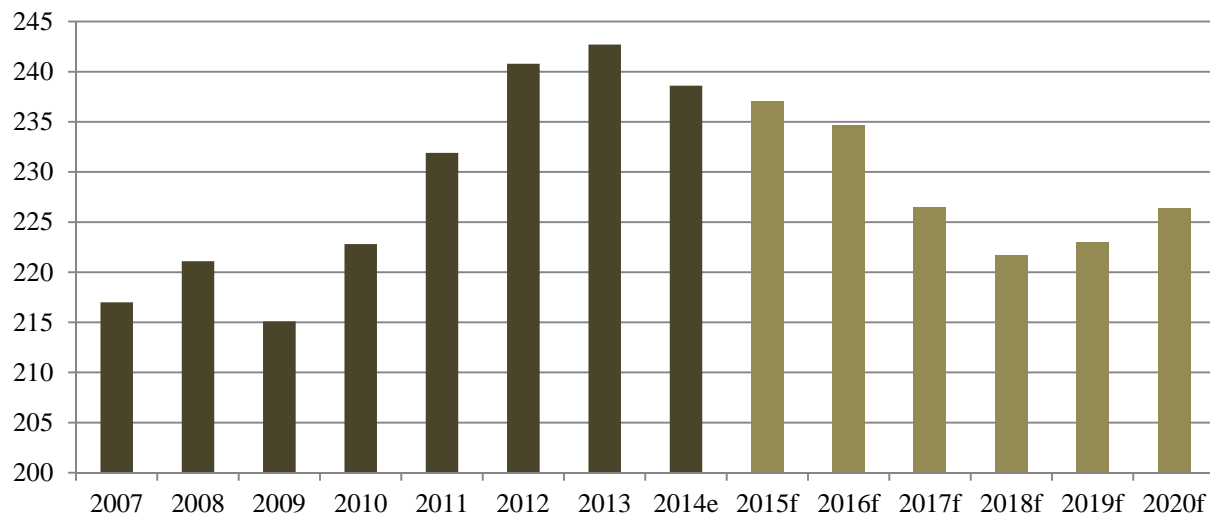
7. Capital investment is expected to decline significantly in 2016, 2017 and 2018 which will have a corresponding negative impact on employment and revenue to the treasury.
8. The Province is forecasting that capital investment will rise in 2019 and 2020 based on the assumption that development of the Bay du Nord oil field will commence. There is no certainty that this will occur by 2019.

Employment

Consistent with the decline in capital investment, the Province is also forecasting a decline in employment levels in 2016, 2017 and 2018. 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 3

Province of Newfoundland and Labrador Employment (Thousands)



Source: Department of Finance

Employment is forecast to rise in 2019 and 2020, presumably on the strength of the Province's expectation that development of the Bay du Nord will commence at that time. Uncertainty around the timing of any development presents a risk to the expected increase in employment and any consequent increase in taxation revenues.

Observation

9. Employment is forecast to rise in 2019 and 2020, presumably on the strength of the Province's expectation that development of the Bay du Nord will commence at that time. Uncertainty around the timing of this development presents a risk to this expected increase in employment.

Deficits

A deficit occurs when the annual level of expenses exceeds the amount of revenue available in the same year. The Province has incurred a deficit in each of 2012-13, 2013-14 and 2014-15 and is predicting that significant deficits will persist in the foreseeable future if action is not taken to address these shortfalls.

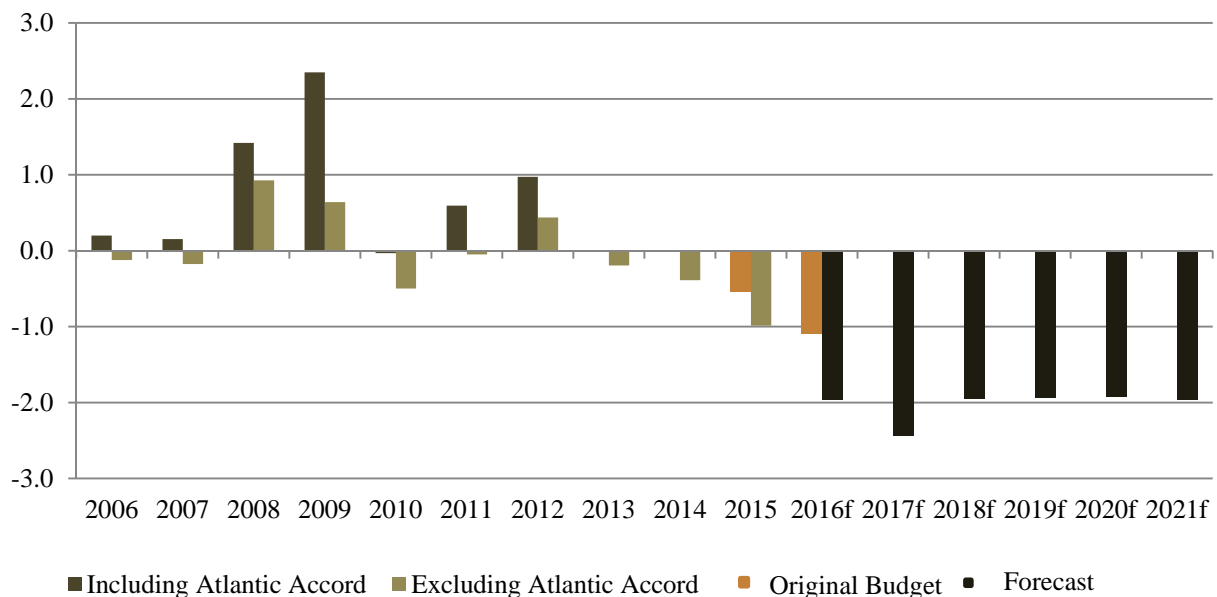
2014-15

For the year ended March 31, 2015, the Province recorded a deficit of \$986 million. This is an increase of \$597 million from the previous year and a \$448 million deterioration from the amount predicted in Budget 2014.

The Province has recorded deficits in the past three consecutive years. The cumulative total of those deficits for these three years exceeds \$1.5 billion. The deficit of \$986 million recorded in 2014-15 is almost 2 ½ times the deficit recorded in 2013-14 and is the highest deficit ever recorded in Newfoundland and Labrador.

Chart 4

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



Revenue in 2014-15 declined by \$564 million from the previous year and also declined by \$813 million from the original budget forecast. These declines were primarily the result of declines in oil royalties.

Expenses increased by \$34 million from the prior year but were \$364 million below the original budget. Budget 2014 had anticipated total expenses of \$8.3 billion, an increase of \$398 million over the previous year.

Observations

10. The actual deficit recorded by the Province for the year ended March 31, 2015 was \$986 million - 2 ½ times greater than the deficit recorded in the previous year and a \$448 million deterioration from the amount predicted in Budget 2014.
11. The deficit of \$986 million recorded in 2014-15 is the highest ever recorded by the Province.
12. The Province has accumulated deficits in excess of \$1.5 billion over the last three fiscal years.
13. Budget 2014 provided for an increase in total expenses of \$398 million in 2014-15, a 5% increase over the previous year, in a year the Province was budgeting for a deficit of \$538 million.

Projected Deficits 2015-16 to 2020-21

The Economic and Fiscal Update released by the Province in December 2015 provided an update on the expected financial results for 2015-16 and an overview of projected deficits to 2020-21 if no action is taken to address these potential outcomes.

2015-16

Budget 2015 originally forecast a deficit of \$1.1 billion for 2015-16. This forecast provided for little change in overall revenue and an increase in expenses of approximately \$160 million.

The Province is now expecting a deficit of \$2.0 billion for 2015-16 which is still subject to considerable risk given the continued weakness of commodity markets. This deficit is almost double the amount predicted at the time of Budget 2015 and will result in a single year deficit that is well in excess of the cumulative deficits of the previous three years.

Revenue, which had been initially forecast to total \$7.0 billion for the year, is now forecast to be \$6.1 billion – a decline of almost 13% from the original expectation. While reductions in oil price and production are cited as the primary reasons for the deterioration of the 2015-16 fiscal position, it is important to remember that the starting point was a projected deficit of \$1.1 billion before any deterioration.

Expenses, which had been budgeted to be \$8.1 billion, are expected to be \$18 million below the original target - a reduction of 0.2%.

Observations

14. The Province is now expecting a deficit of \$2.0 billion for 2015-16, triggered by a decline in revenue of \$888 million, which is still subject to considerable risk given the continued weakness of commodity markets.
15. Reductions in the price of oil and oil production from the amounts originally forecast in Budget 2015 exacerbate a budget deficit starting position that was already at \$1.1 billion.
16. Expenses for 2015-16, which had been budgeted to be \$8.1 billion, are expected to be \$18 million below the original target – a reduction of 0.2%.
17. Budgets 2014 and 2015, combined, provided for increases in expenses of \$558 million in years where budgeted deficits were forecast to total \$1.6 billion.

2016-17 to 2020-21

In the absence of any intervention, the Province is forecasting significant deficits in each of the subsequent five years. Projected deficits for the years 2016-17 to 2020-21 are now forecast to total \$10.2 billion over that period, an amount almost equivalent to the Province's total Net Debt at March 31, 2015.

The deficit projected for 2020-21 is expected to be the same as the deficit for 2015-16 - \$2.0 billion. Revenue is forecast to increase over the period by approximately \$1.1 billion, an increase of 17% - an average of 3.4% per year. The forecast revenue growth is just enough to offset the expected growth in expenses over the period.

Even if expenses remained at the 2015-16 level for the next five years, the Province would still be facing a deficit of over \$900 million in 2020-21.

Given that the current forecast is based on an assumption of steadily increasing oil prices up to 2020-21, there is risk that the forecast revenue growth may not be achieved. The Province did not meet its budgeted revenue target in 2014-15 and is not expected to meet its target in 2015-16.

Observations

18. Projected deficits for the years 2016-17 to 2020-21 are now forecast to total \$10.2 billion - an amount almost equivalent to the Province's total Net Debt at March 31, 2015. Given the current uncertainty regarding the future of commodity prices, the Province cannot support this level of accumulated deficit.
19. Even if expenses remained at the 2015-16 level for the next five years, the Province would still be facing a deficit of over \$900 million in 2020-21.
20. Given that the current forecast is based on an assumption of steadily increasing oil prices up to 2020-21, there is risk that the forecast revenue growth may not be achieved. The Province did not meet its budgeted revenue target in 2014-15 and is not expected to meet its target in 2015-16.

Deficit as a percentage of GDP

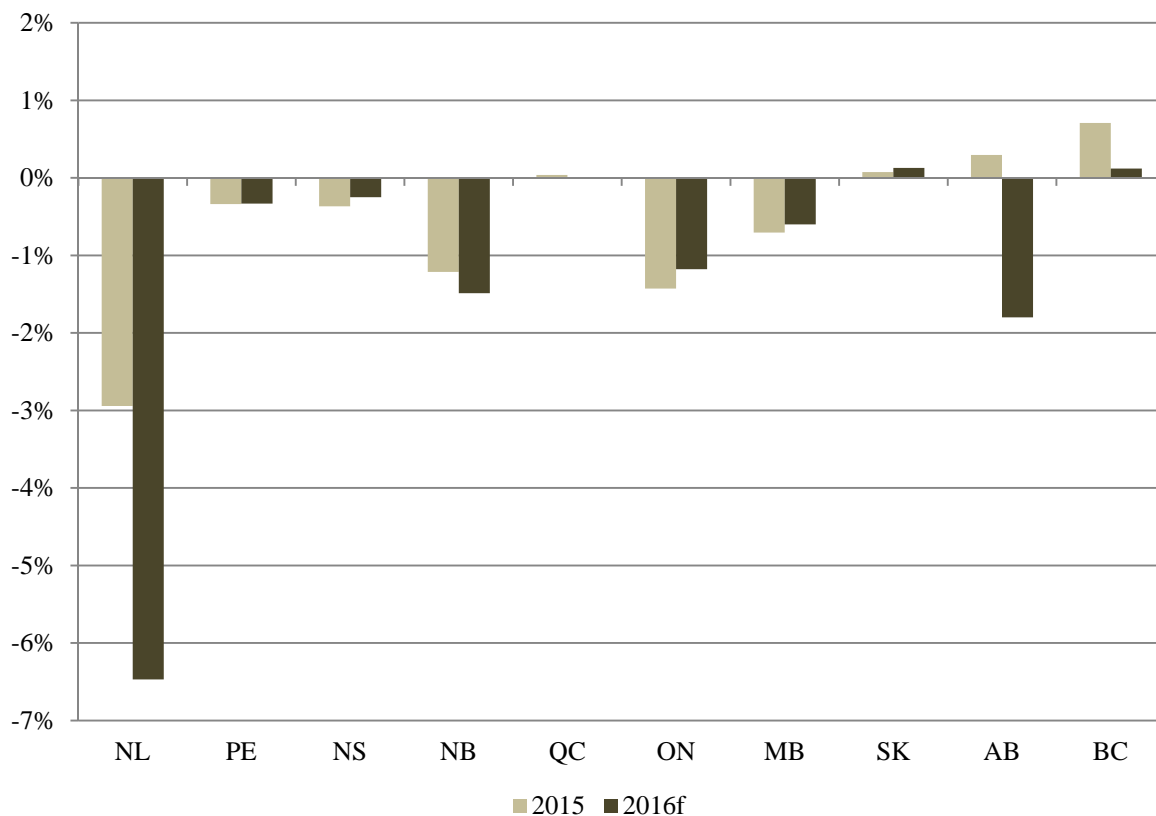
While the absolute amount of the deficit is an important indicator of financial performance, an additional, and more informative, indicator is to express the deficit as a percentage of GDP. This relates the deficit to the size of the Province’s economy and provides a basis for comparison of financial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

2014-15 and 2015-16

Six provinces recorded deficits for 2014-15 and seven are forecasting deficits for 2015-16.

Chart 5

**Provincial Comparison
Deficit as a percentage of GDP
Years ended March 31, 2015 and 2016**



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

Newfoundland and Labrador’s deficit as a percentage of GDP for 2014-15, at 2.9%, is over 2 times greater than the next highest province, Ontario. The forecast deficit as a percentage of GDP for 2015-16 is expected to swell to 6.5% and is approximately 3½ times greater than the next highest province, Alberta.

Observations

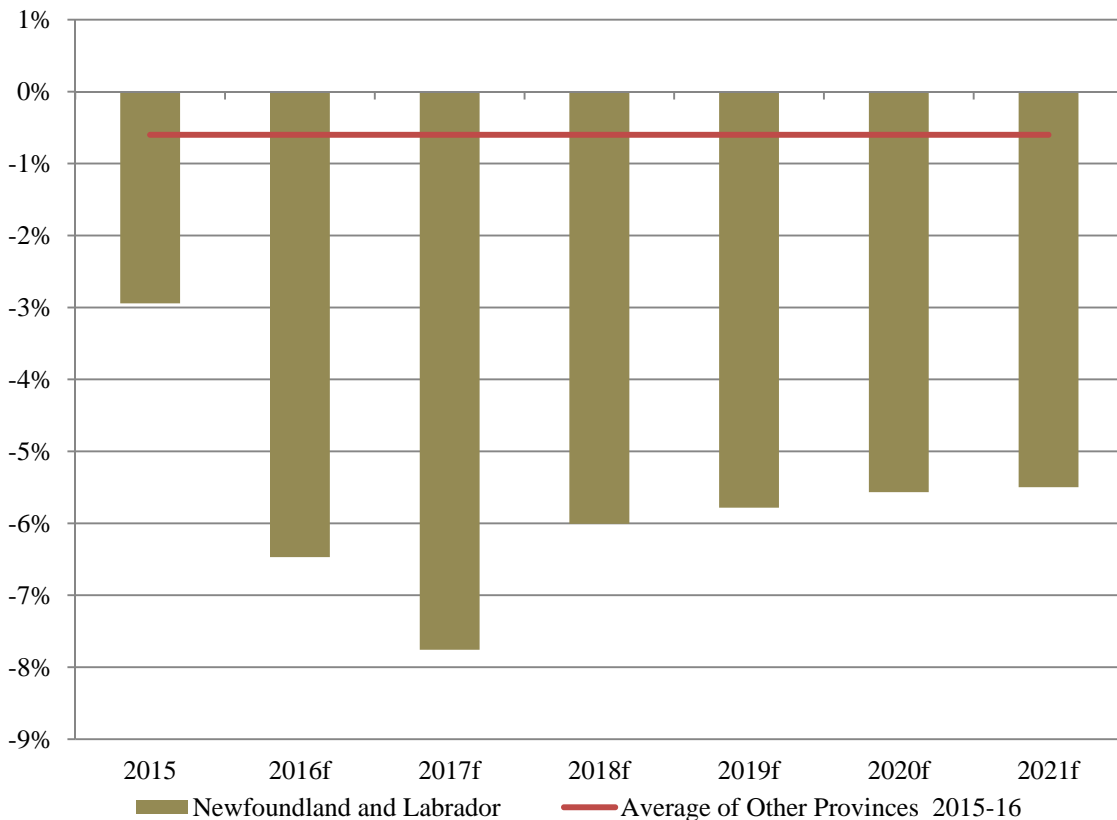
- 21. Newfoundland and Labrador’s deficit as a percentage of GDP for 2014-15 is 2.9% - over 2 times greater than the next highest province.
- 22. The forecast deficit as a percentage of GDP for 2015-16 is expected to increase substantially to 6.5% - approximately 3½ times greater than the next highest province.

2015-16 to 2020-21

The magnitude of the deficits forecast until 2020-21 means that the Province’s relative deficit position will also remain at an extremely elevated level over that period. While the Province is predicting some growth in GDP over the period, this growth is not sufficient to make a significant reduction in the Deficit to GDP ratio. Considerable risk exists that the expected GDP growth could be less than forecast.

Chart 6

**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 13 times higher than the average of all the other provinces, well beyond what would be considered reasonable and sustainable.

Observation

23. Throughout the forecast period, the Province is facing deficits that, in relation to the size of the economy, will be up to 13 times higher than the average of all the other provinces, well beyond what would be considered reasonable and sustainable.

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 and 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.

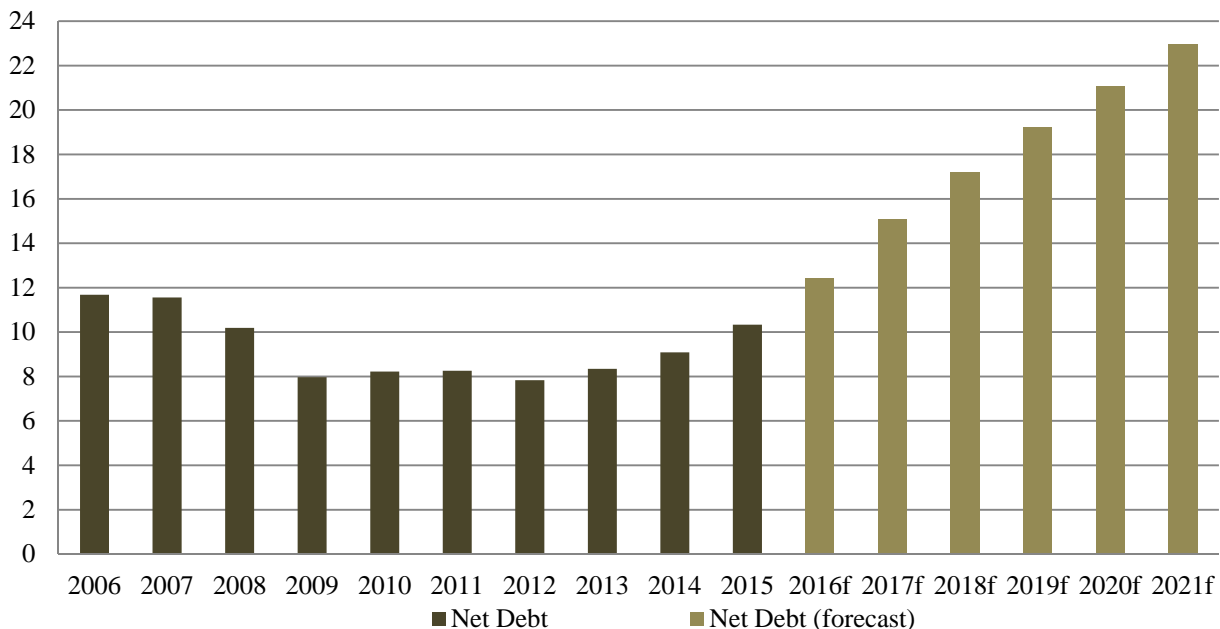
Financial assets are amounts that the Province has available to pay its liabilities or finance future operations. Financial assets consist of cash and temporary investments, amounts receivable from third parties, investments, inventories held for resale and equity in government business enterprises (GBEs) 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 Inc.

2014-15

Net Debt of the Province at March 31, 2015 was \$10.3 billion, an increase of \$1.2 billion from the previous year.

Chart 7

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



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, 2015, Net Debt had increased by approximately \$2.5 billion from its low point in 2011-12, primarily the result of deficits totaling \$1.6 billion in the 2012-13 through 2014-15 fiscal years plus the impact of tangible capital asset acquisition during this period.

Observations

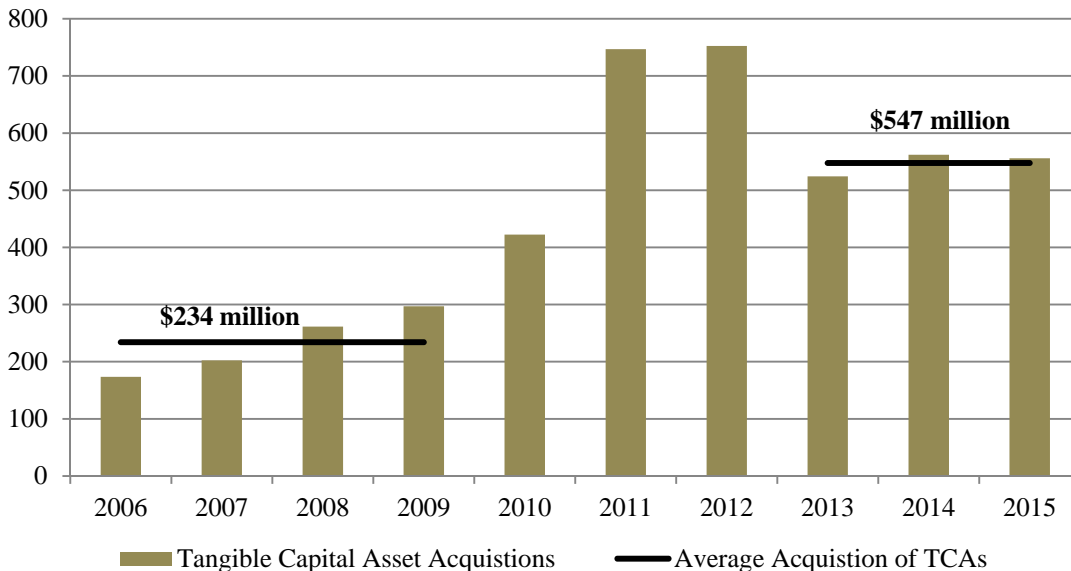
- 24. Net Debt of the Province at March 31, 2015 was \$10.3 billion, an increase of \$1.2 billion from the previous year.
- 25. At March 31, 2015, Net Debt had increased by approximately \$2.5 billion from its low point in 2011-12 primarily the result of deficits totaling \$1.6 billion in the 2012-13 through 2014-15 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 Nalcor), 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 8

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



Prior to 2010, annual spending on tangible capital assets (infrastructure) averaged \$234 million. Spending spiked after the recession of 2008 and 2009 as governments supported the economy through spending on infrastructure. Since the recession-recovery infrastructure initiative, the Province's annual spending on infrastructure has averaged \$547 million - more than double the pre-recession levels.

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

Observations

26. Since the infrastructure spending initiative which was designed to support the economy from 2010 to 2012 after the recession, the Province's annual spending on infrastructure has averaged \$547 million – more than double the pre-recession levels.
27. Any initiative designed to reduce the deficit and, by extension, control the growth in Net Debt will have to consider reductions to the level of spending on new infrastructure in the Province.

2015-16 to 2020-21

The Province is forecasting a deficit of almost \$2 billion in 2015-16. This will increase the Province's Net Debt to \$12.4 billion at March 31, 2016, 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 next six years to 2020-21 and, likely, beyond. These deficits, totaling in excess of \$12 billion, combined with spending on infrastructure over the period are expected to increase Net Debt by \$12.6 billion to an all-time high of \$22.9 billion by March 31, 2021, more than double the current level.

Over the period 2015-16 to 2020-21, the Province expects to borrow \$15.4 billion in the capital markets. This borrowing will be used to:

- refinance 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; and,
- fund the Province's share of equity for the Muskrat Falls project plus required contingent equity to cover any cost overruns.

This level of Net Debt and borrowing is not affordable for the people of the Province and is not sustainable. It is uncertain, even, whether the capital markets would support this level of borrowing by Newfoundland and Labrador given the current financial outlook.

Observations

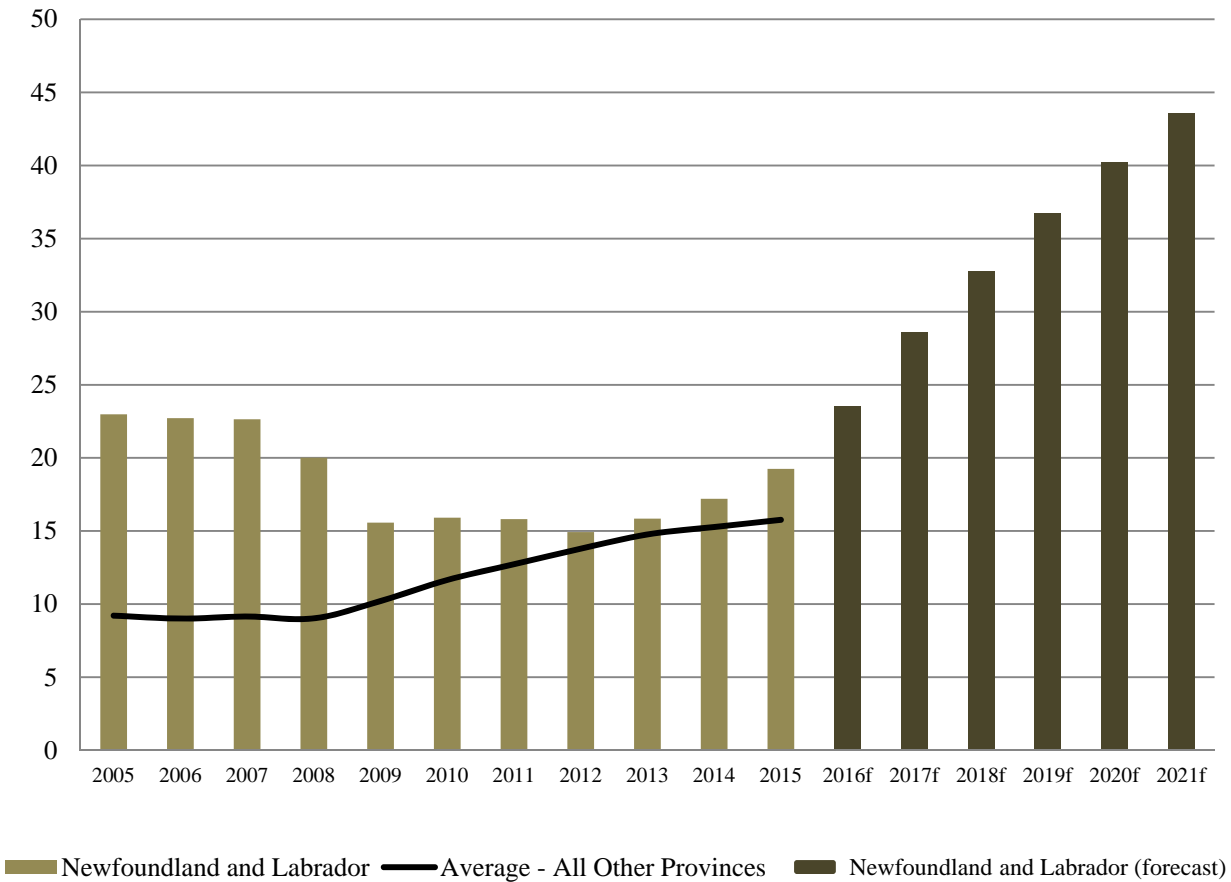
28. The Province's Net Debt is forecast to increase to \$12.4 billion by March 31, 2016, the highest level of Net Debt in the Province's history.
29. Deficits, totaling in excess of \$12 billion, combined with spending on infrastructure from 2015-16 to 2020-21 are expected to increase Net Debt by an additional \$12.6 billion to an all-time high of \$22.9 billion by March 31, 2021, and more than double the current level.
30. Over the period 2015-16 to 2020-21, the Province expects to borrow \$15.4 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; and,
 - meet the Province's equity commitment to the Muskrat Falls project plus any required contingent equity to support any cost overruns on the project.
31. This level of Net Debt and borrowing is not affordable for the people of the Province and is not sustainable. It is uncertain, even, whether the capital markets would support this level of borrowing by Newfoundland and Labrador given the current financial outlook.

Net Debt per Capita

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

Chart 9

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



Source: Public Accounts - all provinces; Statistics Canada

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, 2015, Net Debt per capita has risen to \$19,522. The Province’s position relative to other provinces is deteriorating and the trend is expected to continue, at least until 2020-21. Over this period, Net Debt is forecast to increase significantly and the population is expected to decline from current levels.

By March 31, 2021, Net Debt per capita is expected to reach \$43,603 – almost double the previous high level of \$22,980 at March 31, 2005. This would represent a significant financial burden for each and every Newfoundlander and Labradorian.

Observation

32. By March 31, 2021, Net Debt per capita is expected to reach \$43,603 – almost double the previous high level of \$22,980 at March 31, 2005. This would represent a significant financial burden for each and every Newfoundlander and Labradorian.

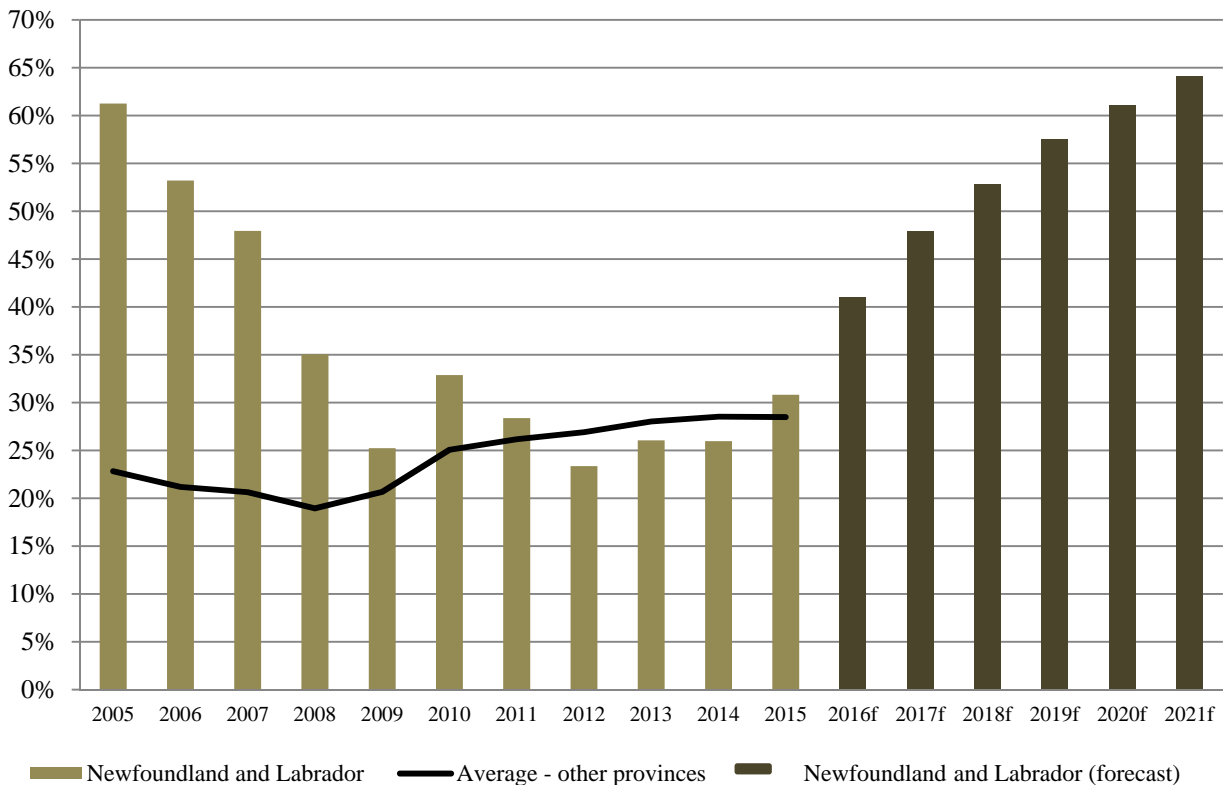
Net Debt as a percentage of GDP

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 10

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



The Financial Condition of the Province

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, 2015, the Province's Net Debt as a percentage of GDP has climbed to 30.8% and is now higher than the average of all other provinces. While this level of relative Net Debt would ordinarily be considered reasonable and sustainable, when combined with the current forecast over the next six years, the outlook is worrisome.

Without action by the Province to slow the growth of Net Debt, the ratio of Net Debt to GDP is forecast to grow to 64.2% by March 31, 2021 – the highest level in the Province's history.

Observations

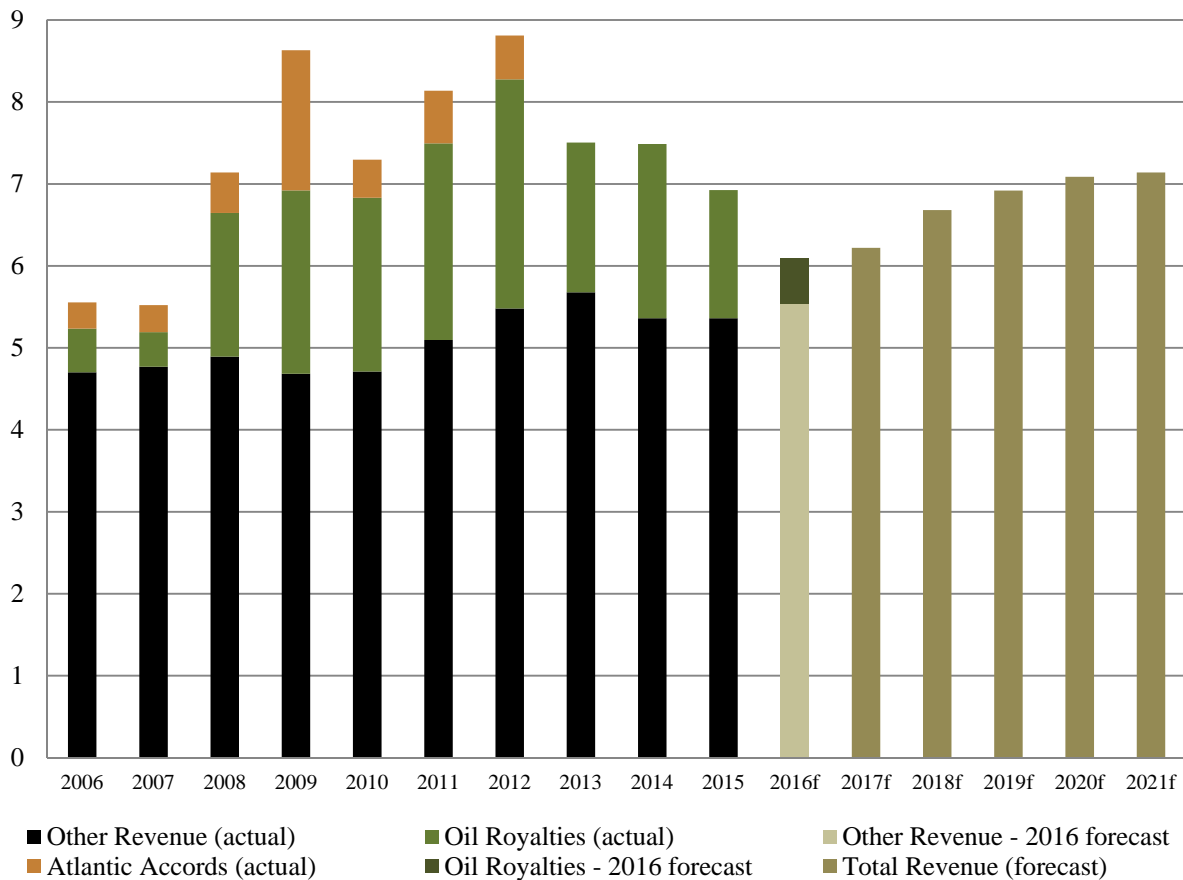
33. The absolute level of Net Debt and the ratio of Net Debt to GDP at March 31, 2015 would ordinarily be considered reasonable and sustainable, however, when combined with the current forecast over the next six years, the outlook is worrisome.
34. Without action by the Province to slow the growth of Net Debt, the ratio of Net Debt to GDP is forecast to grow to 64.2% by March 31, 2021 – the highest level in the Province's history.

Revenues

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

Chart 11

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



Revenue (excluding revenue received under the Atlantic Accord arrangements) peaked in 2011-12 at \$8.3 billion. Total revenue in 2014-15 was \$6.9 billion, a reduction of \$564 million from the previous year and a reduction of \$1.4 billion from the peak in 2011-12.

For 2015-16, oil royalties are forecast to decline significantly from \$1.6 billion in 2014-15 to \$552 million, a decline of \$1 billion in just one year. 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 2020-21, the Province is forecasting that total revenue will increase an average of 3.4% a year to reach \$7.1 billion. This represents an additional \$1.1 billion in revenue over the five year period but will only have recovered to the level just above that of 2014-15.

This growth in revenue is dependent on the Province achieving the expected economic growth that it has forecast and the levels of oil production and oil price outlined in the December 2015 Economic and Fiscal Update.

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

35. For the year ended March 31, 2015, total revenue was \$1.4 billion below the peak achieved in 2011-12.
36. For 2015-16, oil royalties are forecast to decline significantly from \$1.6 billion in 2014-15 to \$552 million, a decline of \$1 billion in just one year.
37. The Province is forecasting revenue to grow by \$1.1 billion over the five year period to 2020-21. This growth in revenue is dependent on the Province achieving the economic growth that it has forecast and the levels of oil production and oil price outlined in the December 2015 Economic and Fiscal Update. 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 2014-15, oil royalties dropped to \$1.6 billion and only represented 22.6% of total revenues. In 2015-16, the Province is expecting oil royalties of \$552 million - a decline to 9.1% of total revenue.

Observations

- 38. Oil royalties in 2014-15 were \$1.6 billion, a drop of \$1.2 billion from the peak of \$2.8 billion in 2011-12.
- 39. In 2015-16, oil royalties are expected to account for just 9.1% of revenue, a significant drop in four 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.

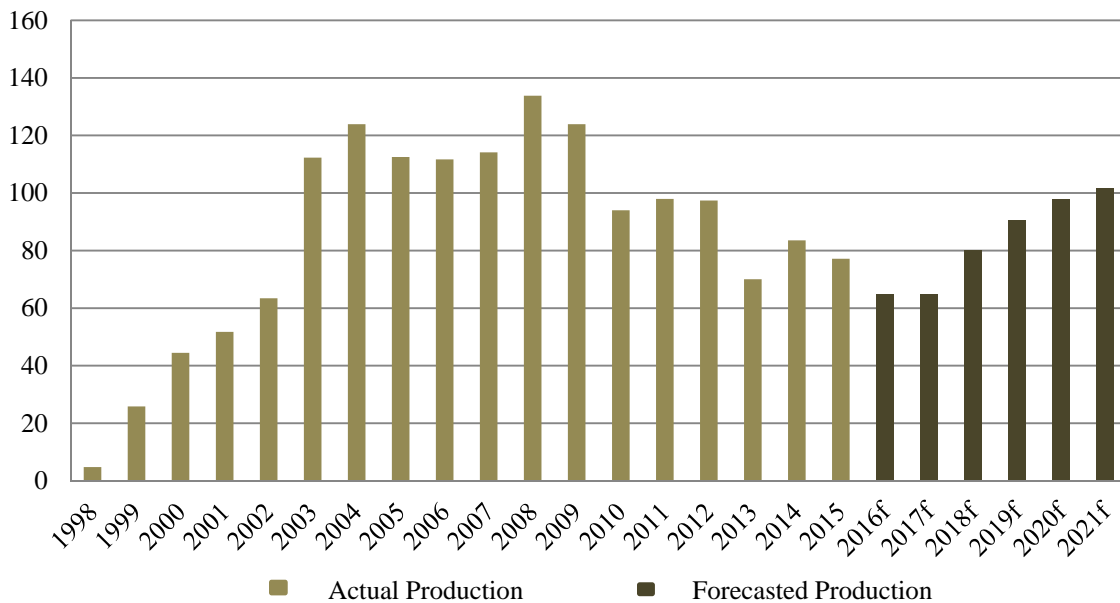
Given its lack of control over the factors that impact oil royalties, and its increasing reliance on this revenue source, Government has to carefully consider the degree to which it can rely on this revenue source to fund its programs and services in the future.

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 77.2 million barrels in 2014-15.

Chart 12

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



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

Production is currently forecast by the Province to drop to 65 million barrels for both 2015-16 and 2016-17 before beginning to recover in 2017-18 and beyond. By 2020-21, oil production is forecast to be 101.6 million barrels. The increase in production is attributed, primarily, to the commencement of production from the Hebron field, expected toward the end of 2017.

Observation

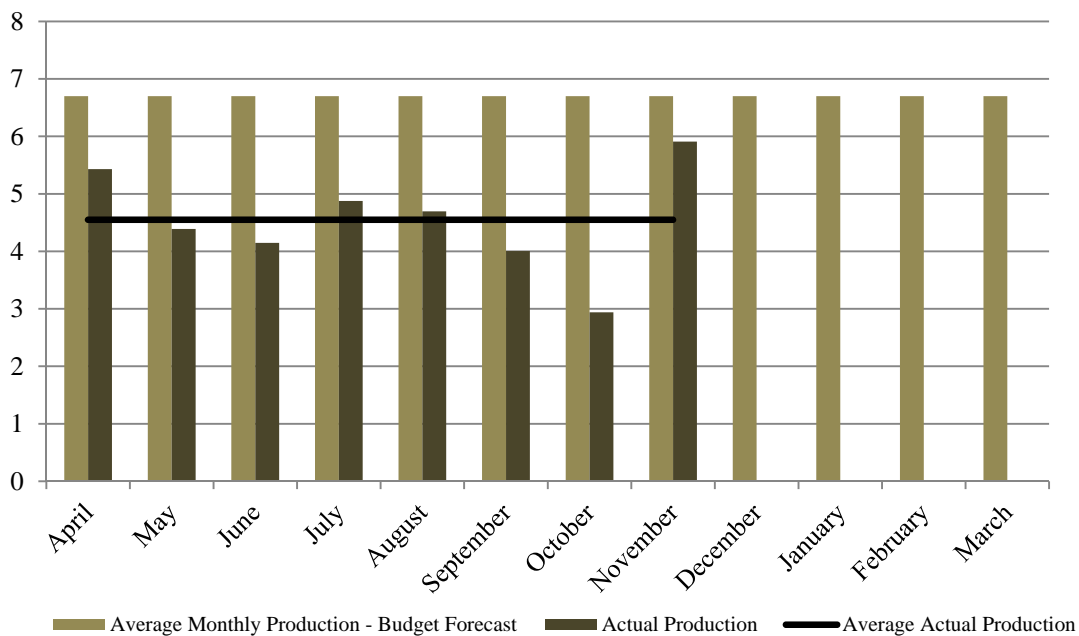
40. Annual production of offshore oil has shown a downward trend since 2007-08.

2015-16

Production for 2015-16 had initially been forecast to be 80.3 million barrels in Budget 2015 – an average of 6.7 million barrels per month.

Chart 13

**Province of Newfoundland and Labrador
Oil production
Year ended March 31, 2016
(Million barrels)**



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

From April to November 2015, actual monthly production has been consistently below the original forecast and has averaged only 4.55 million barrels per month. In December 2015, the Province revised its production estimate downward to 64.9 million barrels for the year. Given that total production for the first 8 months was 36.4 million barrels, production for the last four months will have to total 28.5 million barrels in order to meet the revised target. This represents average production of 7.1 million barrels in these four months, considerably higher than monthly production to date.

This indicates there is considerable risk that the revised production target will not be met for 2015-16 and also indicates there could be some risk that the 2016-17 production levels may be optimistic. This could negatively affect the deficit outlook for these years.

Observation

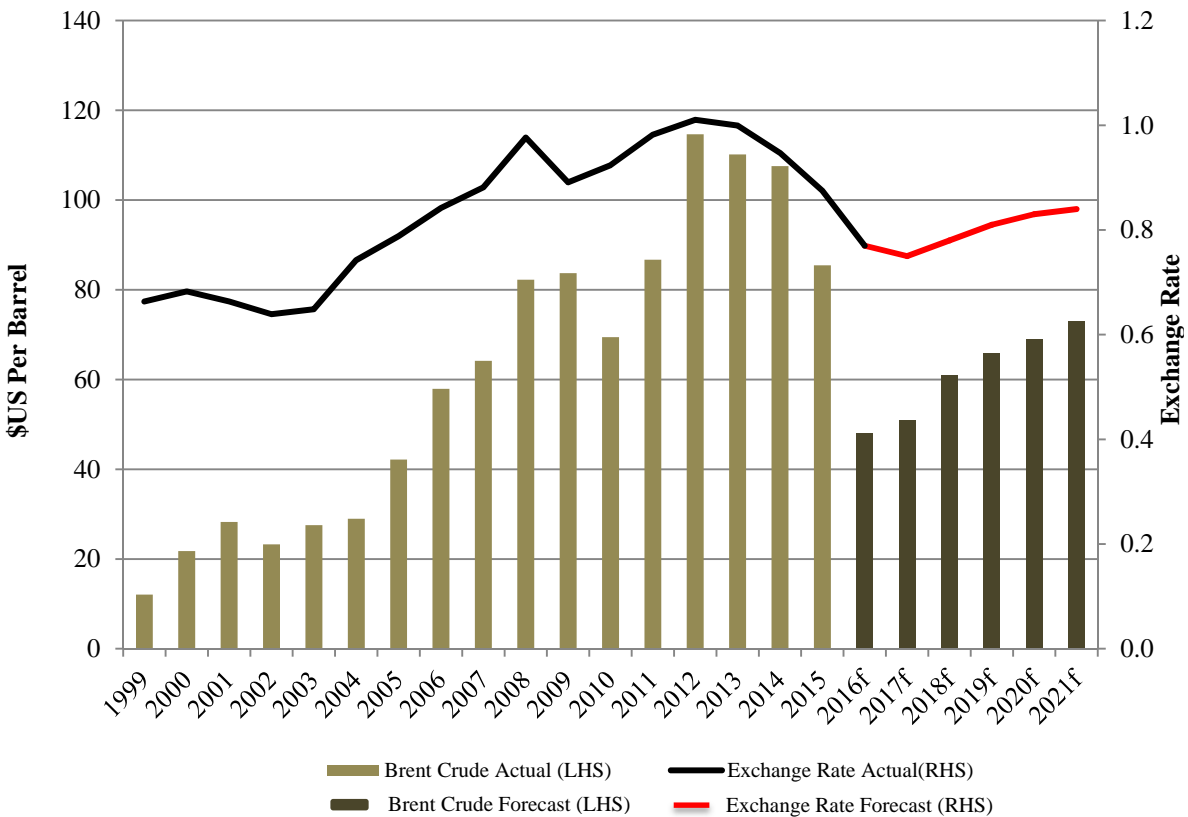
41. There is considerable risk that the revised oil production target for 2015-16 will not be met and there is also risk that the forecast 2016-17 production levels may be optimistic. This could negatively affect the deficit outlook for these years.

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 14

**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)

2014-15

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 2014-15 the average price of Brent crude was \$US85.46.

Observation

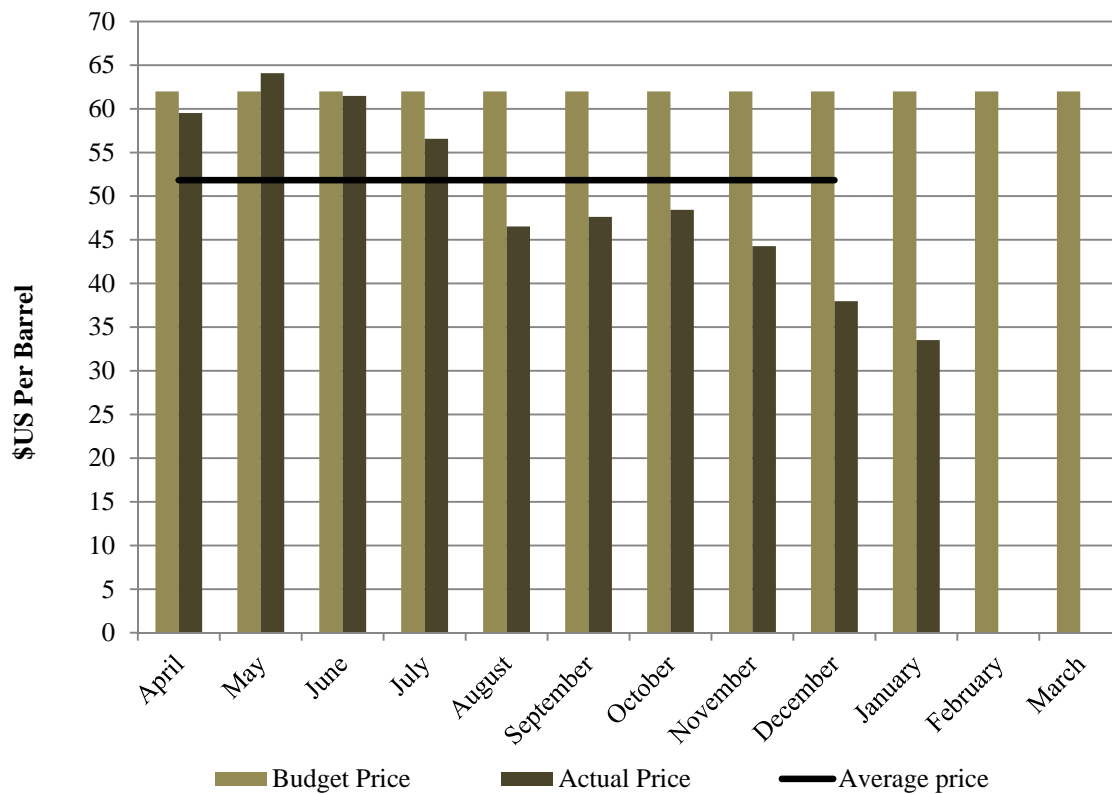
42. The average annual price of Brent Crude peaked in 2011-12 at \$US114.65 per barrel and has been steadily declining since that time. In 2014-15, the price of Brent crude averaged \$US85.46 per barrel.

2015-16

Budget 2015 had initially forecast the price of Brent crude to be \$US62 per barrel for 2015-16.

Chart 15

**Province of Newfoundland and Labrador
Oil price
Year ended March 31, 2016**



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

The price of Brent crude has averaged \$US51.83 from April to December 2015, however, this average is heavily influenced by higher prices during the first four months of the fiscal year. The price of Brent crude in December 2015 averaged \$US37.97.

In December 2015, the Province revised its oil price forecast for 2015-16 down to an average of \$US48 per barrel. In order to meet this target, oil prices will need to average \$US36.67 per barrel in January, February and March 2016. The average price, to date, in January 2016 is \$US33.52. While this target is potentially achievable, there is some risk associated with the forecast.

Observation

43. In December 2015, the Province revised down its oil price forecast for 2015-16 from \$US62 per barrel to an average of \$US48 per barrel. In order to meet this target, oil prices will need to average \$US36.67 per barrel in January, February and March 2016. The average price, to date, in January 2016 is \$US33.52. While this target is potentially achievable, there is some risk associated with the forecast.

2016-17 to 2020-21

Of greater risk is the forecast for 2016-17 to 2020-21. 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 \$US48 in 2015-16 and expects to see steady annual increases to \$US73 per barrel by 2020-21. Even at an average Brent crude price of \$US85 per barrel, the Province recorded a deficit of \$986 million in 2014-15.

Observation

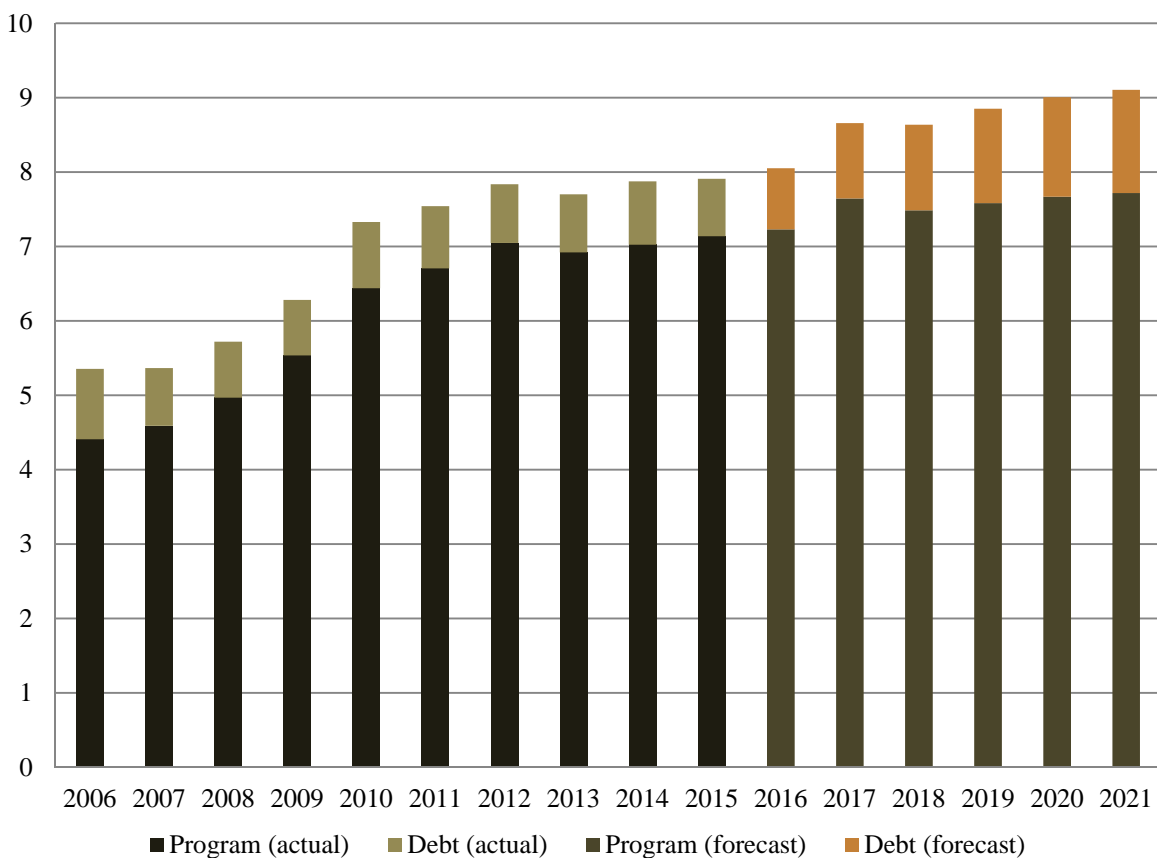
44. The Province is forecasting the price of Brent crude to average \$US48 in 2015-16 and expects to see steady annual increases to \$US73 per barrel by 2020-21. The farther in the future the forecast goes, the greater the risk around predicting oil prices at that time. Even at an average Brent crude price of \$US85 per barrel, the Province recorded a deficit of \$986 million in 2014-15.

Expenses

Total expenses have grown from \$5.4 billion in 2005-06 to \$7.9 billion in 2014-15, an increase of \$2.5 billion or 46%.

Chart 16

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



The current forecast to 2020-21 indicates further growth in total expenses of \$1.2 billion or 15.2%.

Observation

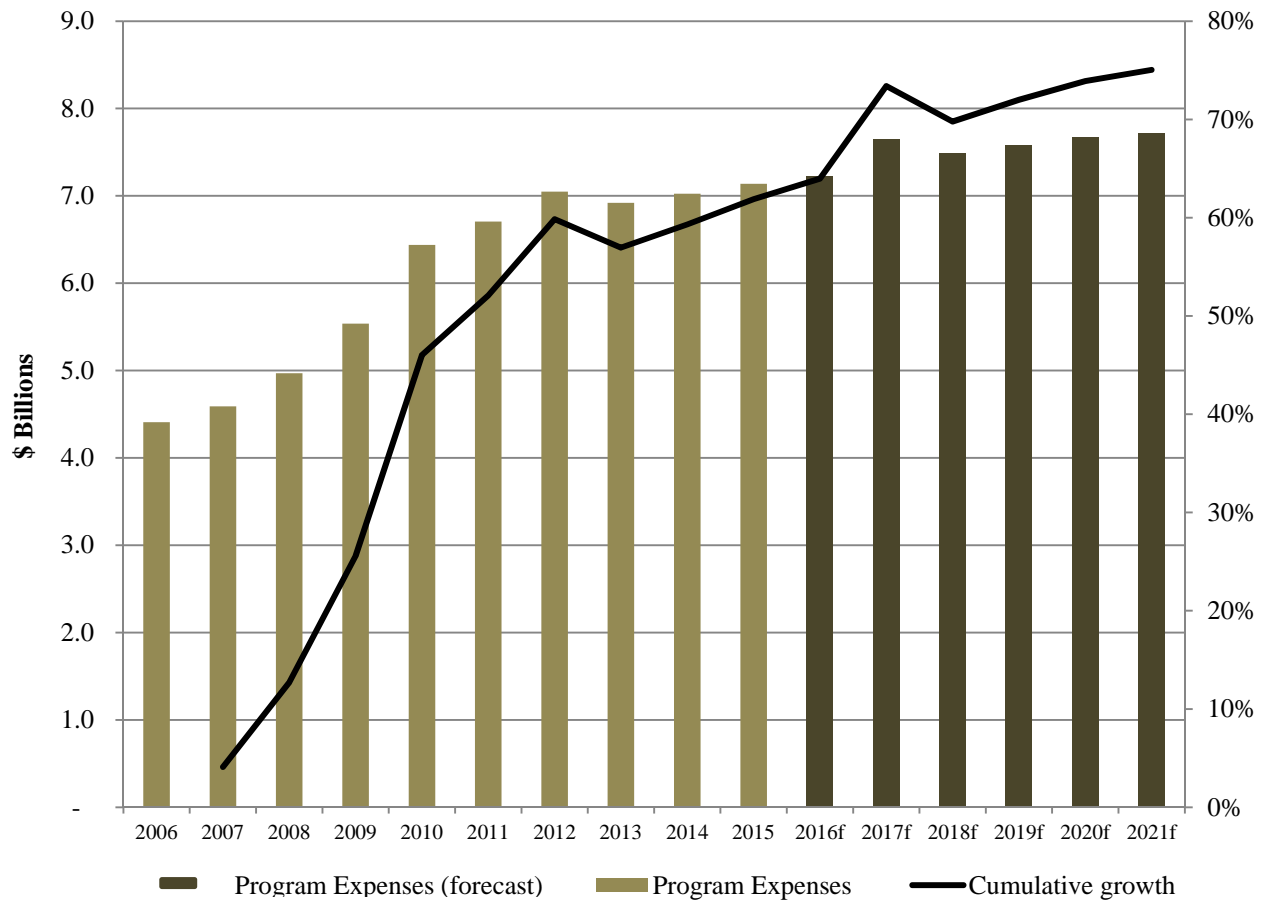
45. Total expenses have grown from \$5.4 billion in 2005-06 to \$7.9 billion in 2014-15, an increase of \$2.5 billion or 46%.

Program Expenses

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

Chart 17

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



2005-06 to 2014-15

Since 2005-06, program expenses have grown by \$2.7 billion to \$7.1 billion in 2014-15. This represents cumulative growth over that period of 62.0%. The largest portion of this growth occurred between the period 2005-06 and 2009-10, a period when the Province was experiencing strong revenue growth.

While growth in program expenses slowed from 2011-12 until 2014-15, an additional \$432 million was added to the program expenses base over that period.

Observation

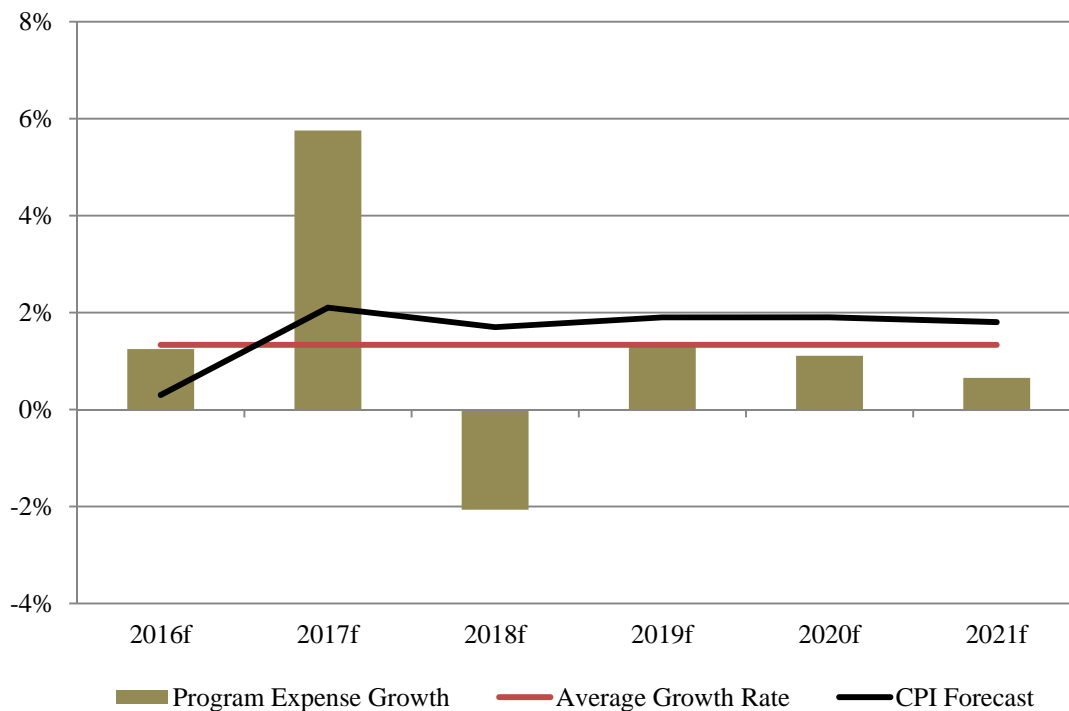
46. Program expenses have grown by 62.0% over the ten year period from 2005-06 to 2014-15.

2015-16 to 2020-21

In December 2015, the Province updated its forecast of expected levels of expenses to 2020-21 before any specific action to manage expenses as part of an exercise to reduce the size of the anticipated deficits.

Chart 18

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



This “status quo” forecast expects average expense growth of 1.3% from 2015-16 to 2020-21, roughly matching the Province’s expected CPI growth over the same period. This, in essence, would not allow for any new program initiatives but would still add \$580 million in new expenses just from inflationary pressures. A \$2 billion deficit is still anticipated in 2020-21 despite a forecast of modest expense growth.

Observations

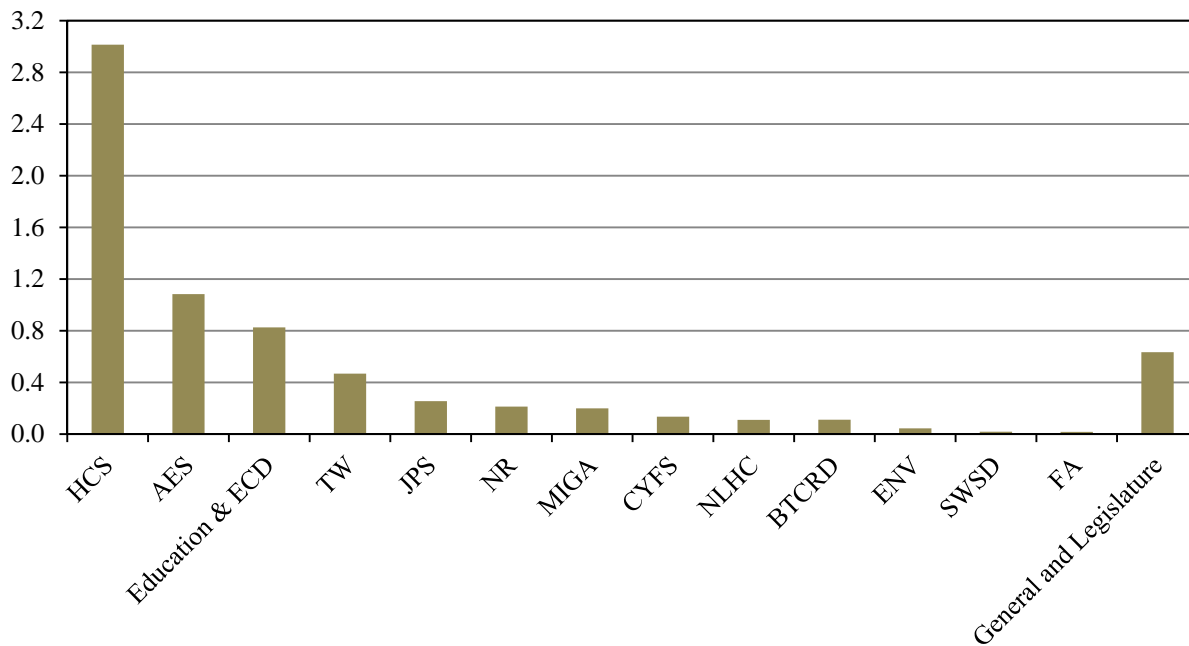
- 47. Program expenses are forecast to increase by \$580 million from 2014-15 to 2020-21, an average growth rate of 1.3%. This level of expense increase approximates the expected rate of inflation and, in essence, would not provide for any growth in program initiatives.
- 48. A \$2 billion deficit is still anticipated in 2020-21 despite a forecast of modest expense growth.

Program Expenses by Department

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

Chart 19

Consolidated Summary Financial Statements
Program Expenses by Department
Year ended March 31, 2015
(\$ Billions)



\$3.0 billion of the \$7.1 billion of program expenses incurred in 2014-15 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, 42% is spent on health care.

The Departments of Advanced Education and Skills and Education and Early Childhood Development, combined, account for \$1.9 billion of program expenses, or almost 27% of the total. This includes spending on the K-12 system, the university and college, as well as income support and skills development.

Almost 70% of program expenses are directed to the health, education and skills development sectors.

The General and Legislature category of expenses includes government wide employee benefits.

Given that the nature of Government program expenses relate to social need, it is difficult to significantly adjust the level of expenses in a short time frame.

Observations

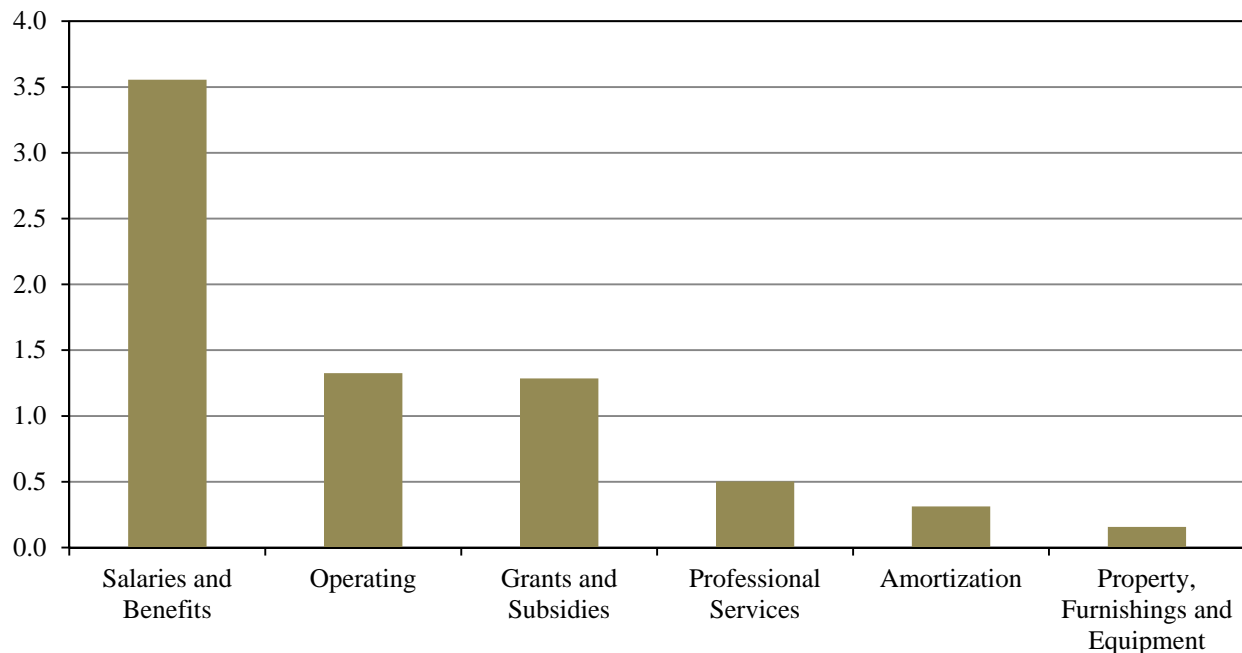
49. Almost 70% of program expenses are directed to the health, education and skills development sectors.
50. Given that the nature of Government program expenses relate to social need, it is difficult to significantly adjust the level of expenses in a short time frame.

Program Expenses by Category

Government is in the business of providing services to residents throughout the Province.

Chart 20

Consolidated Summary Financial Statements Program Expenses by Category Year ended March 31, 2015 (\$ Billions)



As with any organization providing a service or services, the Province spends the majority of its expenses on human resources – its employees. In 2014-15, the Province spent \$3.6 billion on salaries and employee benefits which represents 50% of the total program spending of Government.

Not only is 70% of spending directed to health, education and skills development, but, 50% of those costs are related to people.

Observation

51. In 2014-15, the Province spent \$3.6 billion on salaries and employee benefits which represents 50% of the total program spending of Government.

Attrition Plan

In April 2015, the Province announced an Attrition Plan which was designed to take advantage of expected retirements in order to reduce the size of the workforce.

Table 1

**Province of Newfoundland and Labrador
Attrition Plan Summary
2015-16 to 2019-20**

Year	Positions			Anticipated Savings
	Core Government	Broader Public Service	Total	(\$ Millions)
2015-16	87	197	284	20
2016-17	174	394	568	40
2017-18	261	591	852	60
2018-19	348	788	1,136	80
2019-20	435	985	1,420	100

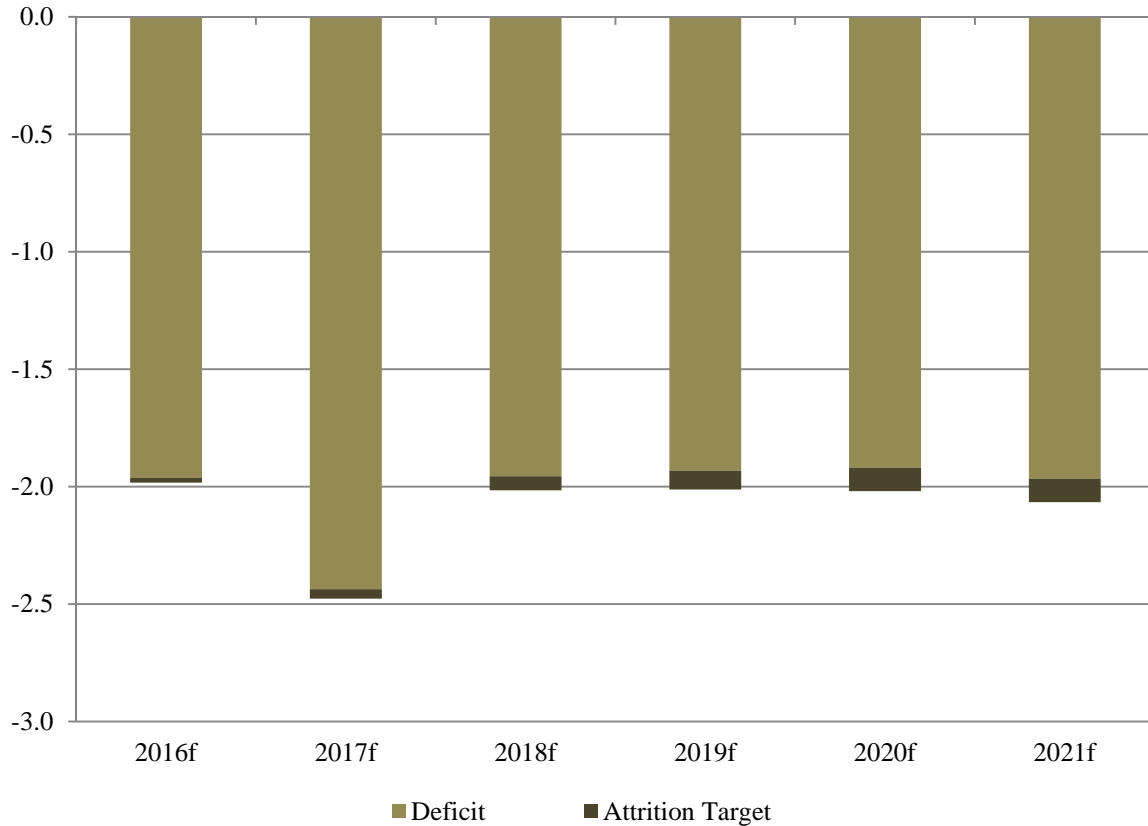
The Plan is to be implemented over a five year period and is expected to reduce the public sector workforce by 1,420 people at the end of 2019-20 with associated annual savings of \$100 million when fully implemented.

While attrition is, conceptually, a way to reduce the workforce without layoffs, in the absence of reductions in specific programs, it may be difficult to manage in practice. The skills of those retiring may not match with operational requirements.

Also, given the magnitude of the budget deficit, the Attrition Plan alone will not achieve meaningful expense reductions. In fact, the attrition targets should already be factored into the projected deficits.

Chart 21

**Province of Newfoundland and Labrador
Attrition Plan
Impact on Deficit
2015-16 to 2020-21
(\$ Billions)**



With a current government workforce in excess of 46,000 people, the Attrition Plan is targeting to reduce this number by 3.0%.

Observation

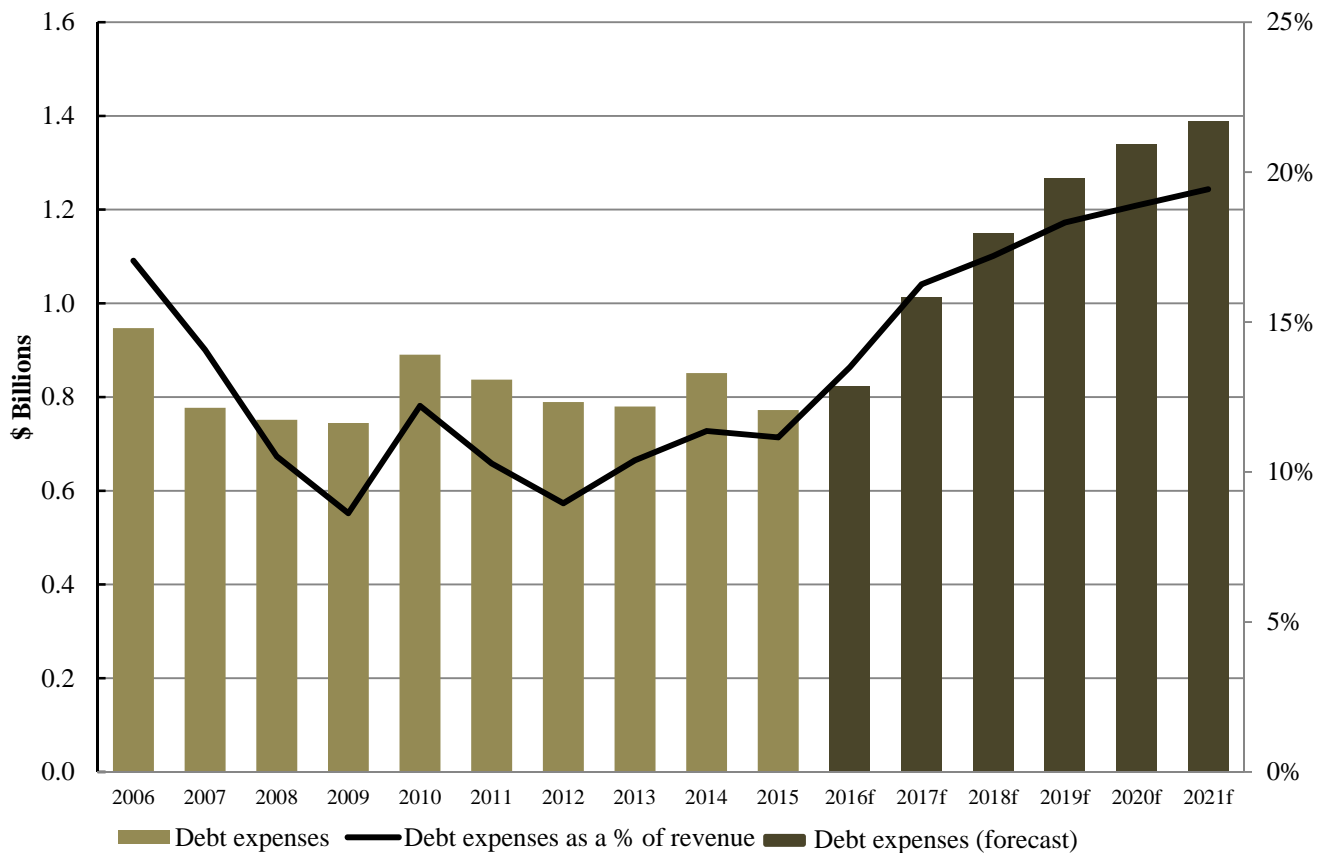
52. The Attrition Plan, currently targeting to reduce the workforce by approximately 3.0%, or 1,420 persons, will not be enough to achieve the expense reductions necessary to significantly reduce the deficit.

Interest costs

Government incurs interest costs on its borrowings, as well as on its liabilities related to employee post-retirement benefits. At March 31, 2015, Government’s borrowings, net of sinking funds, were \$5.5 billion, its unfunded pension liability was \$4.4 billion and its unfunded group health and life insurance retirement benefits liability was \$2.6 billion.

Chart 22

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



From 2005-06 to 2014-15 interest expense averaged \$814 million. The forecast from 2015-16 to 2020-21 sees interest expense increasing to almost \$1.4 billion annually, the result of borrowing to finance deficits in those years and for other purposes. If action is not taken to significantly reduce forecast deficits, by 2020-21, the Province will be allocating an additional \$600 million annually to service its debt.

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 declined overall since 2006 and is at 11.2% for 2014-15. However, debt expenses as a percentage of revenue are forecast to increase, and by 2020-21 almost 20% of every dollar of revenue generated is forecast to be allocated to interest expense.

Observations

53. Interest expense totaled \$772 million in 2014-15 and is forecast to increase to almost \$1.4 billion annually by 2020-21, the result of borrowing to finance deficits in those years and for other purposes. This means an additional \$600 million annually will have to be allocated to service the Provinces debt if action is not taken to reduce forecast annual deficits.
54. Money allocated to servicing debt is money that is not available to fund programs and services.
55. By 2020-21, almost 20% of every dollar of revenue generated is forecast to be allocated to interest expense.

Dealing with the Deficit

The Province has a number of options to consider in assessing how to tackle the deficit and a number of policy levers which it can use to reduce the size of the deficit.

An economic and budget forecast which considers a variety of scenarios around growth and expected changes in commodity prices will be a critical element in taking the first step to decision making. This will form the basis for determining medium-term deficit targets and a realistic timeframe to achieve those targets and ultimately return to a balanced budget.

While resource revenues are tied to external factors beyond the control of the Province, taxation is an area within the control of Government and which will have to be considered as part of a deficit reduction plan. Personal income tax and the HST are the two largest revenue sources for the Province. Increases to those, along with other consumption taxes, such as gasoline tax, and corporate income taxes, will have to be considered as part of a balanced package to achieve Government's objective.

Taxation revenues total approximately \$3.0 billion annually. Increases in taxation alone are unlikely to solve the \$2.0 billion deficit problem but can contribute to the solution.

Reductions to program expenses, which are expected to be \$7.2 billion in 2015-16, is the area where the Province has the most flexibility in order to reduce the deficit. Program spending by sector is approximately as follows:

- General government and legislative 15%
- Resource (includes advanced education) 20%
- Social 65%

Given the magnitude of the forecast deficits, any meaningful reductions in spending will, of necessity, have to consider reductions throughout the entire breadth of Government services, including health and education. In addition, considering that 50% of program expenses are related to human resources, reductions to the size of the workforce will also be necessary.

Observations

56. A forecast which considers a variety of scenarios around growth and expected changes in commodity prices will be a critical element in taking the first step to decision making. This will form the basis for determining medium term deficit targets and a realistic timeframe to achieve those targets and ultimately return to a balanced budget.
57. Increases to personal income tax and the HST, along with other consumption taxes, such as gasoline tax, and corporate income taxes, will have to be considered as part of a balanced package to achieve Government's deficit reduction objective.

58. Given the magnitude of the forecast deficits, any meaningful reductions in spending will, of necessity, have to consider reductions throughout the entire breadth of Government services, including health, education and skills development.
59. Considering that 50% of program expenses are related to human resources, reductions to the Government workforce will be necessary to achieve significant expense reductions.

Consequences of Inaction

As the Province carries out its deficit reduction strategy, it will have to rely on the capital markets to raise funds to finance deficits as the plan is implemented. Borrowing costs will likely rise as the plan unfolds.

In the absence of a credible plan, borrowing costs could rise even higher and the Province could see its access to capital markets restricted.

Observation

60. Inaction could result in increased borrowing costs and restricted access to capital markets.

CHAPTER
4
FINANCIAL ACCOUNTABILITY

Background

This Report provides information on the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador for the year ended March 31, 2015. 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.

Financial Accountability

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, 2015

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

Financial Accountability

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 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 911 Bureau Inc.	
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, 2015, 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, 2015), 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, 2015) 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, 2015, 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.

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CHAPTER

5

**UNDERSTANDING THE CONSOLIDATED
SUMMARY FINANCIAL STATEMENTS**

Introduction

The Consolidated Summary Financial Statements present the most comprehensive view of the financial position of the Province as at March 31, 2015. 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, 2015). 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, 2015.

Table 1

Consolidated Summary Financial Statements
Components of the Consolidated Statement of Financial Position
As at March 31, 2015
(\$000s)

Component	Amount
Financial Assets	\$ 5,103,232
Liabilities	15,432,798
Net Debt	10,329,566
Non-financial Assets	4,349,277
Accumulated Deficit	\$ 5,980,289

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, 2015.

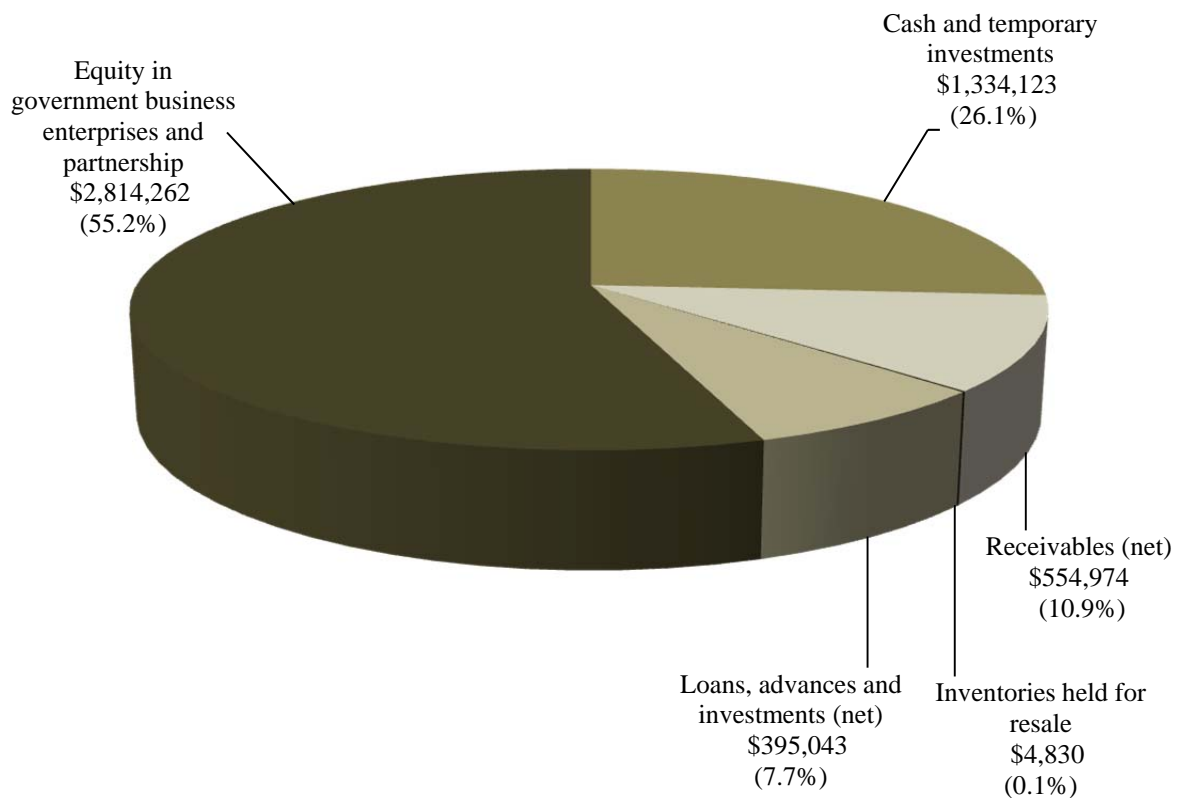
Chart 1

Consolidated Summary Financial Statements

Financial Assets

As at March 31, 2015

(\$000s)



Total: \$5,103,232

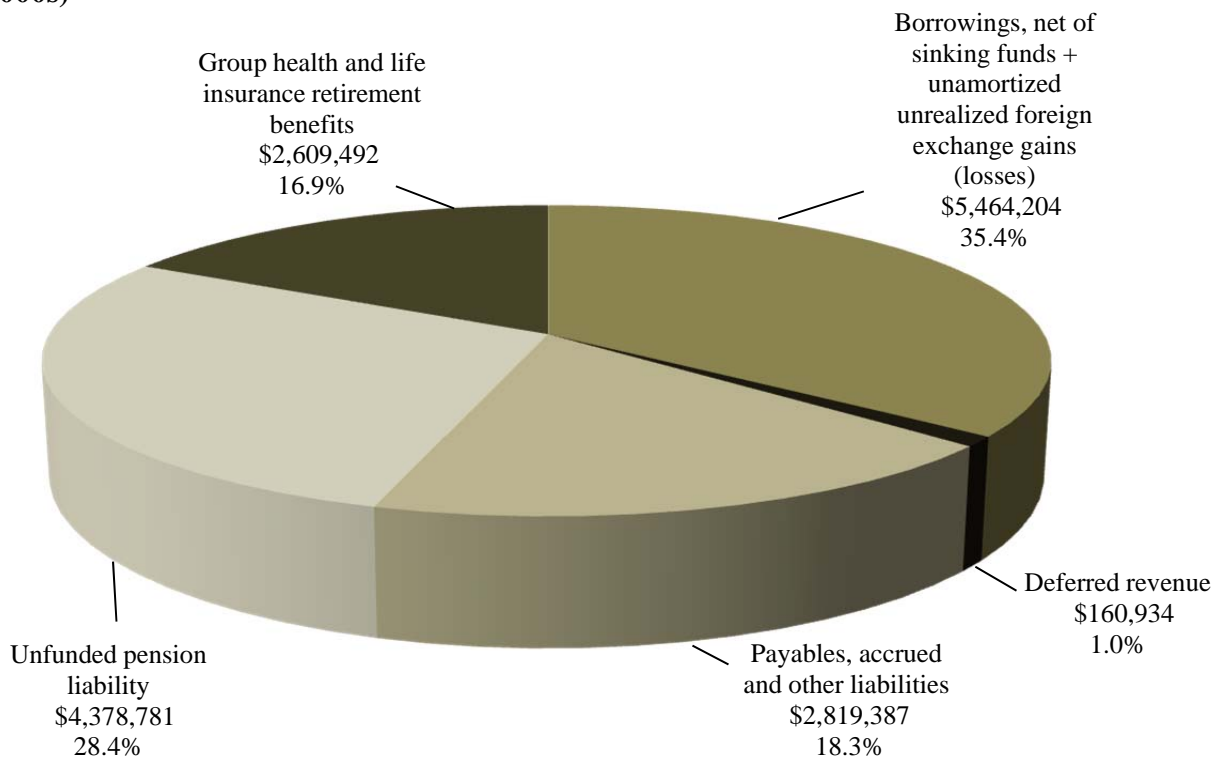
Equity in Government Business Enterprises and partnership reflects the net assets (assets less liabilities) of Nalcor Energy, the Newfoundland and Labrador Liquor Corporation, and Government's 25% equity interest in the Atlantic Lottery Corporation, Inc. This equity is used by these entities to generate 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, 2015.

Chart 2

**Consolidated Summary Financial Statements
Liabilities
As at March 31, 2015
(\$000s)**



Total: \$15,432,798

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, 2015 was \$10.3 billion (2014 - \$9.1 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, 2015 were:

• Tangible capital assets	\$4.26 billion
• Prepaid expenses, deferred charges and inventories	<u>0.09 billion</u>
Total Non-financial Assets	<u>\$4.35 billion</u>

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, 2015 was \$6.0 billion (2014 - \$4.9 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.

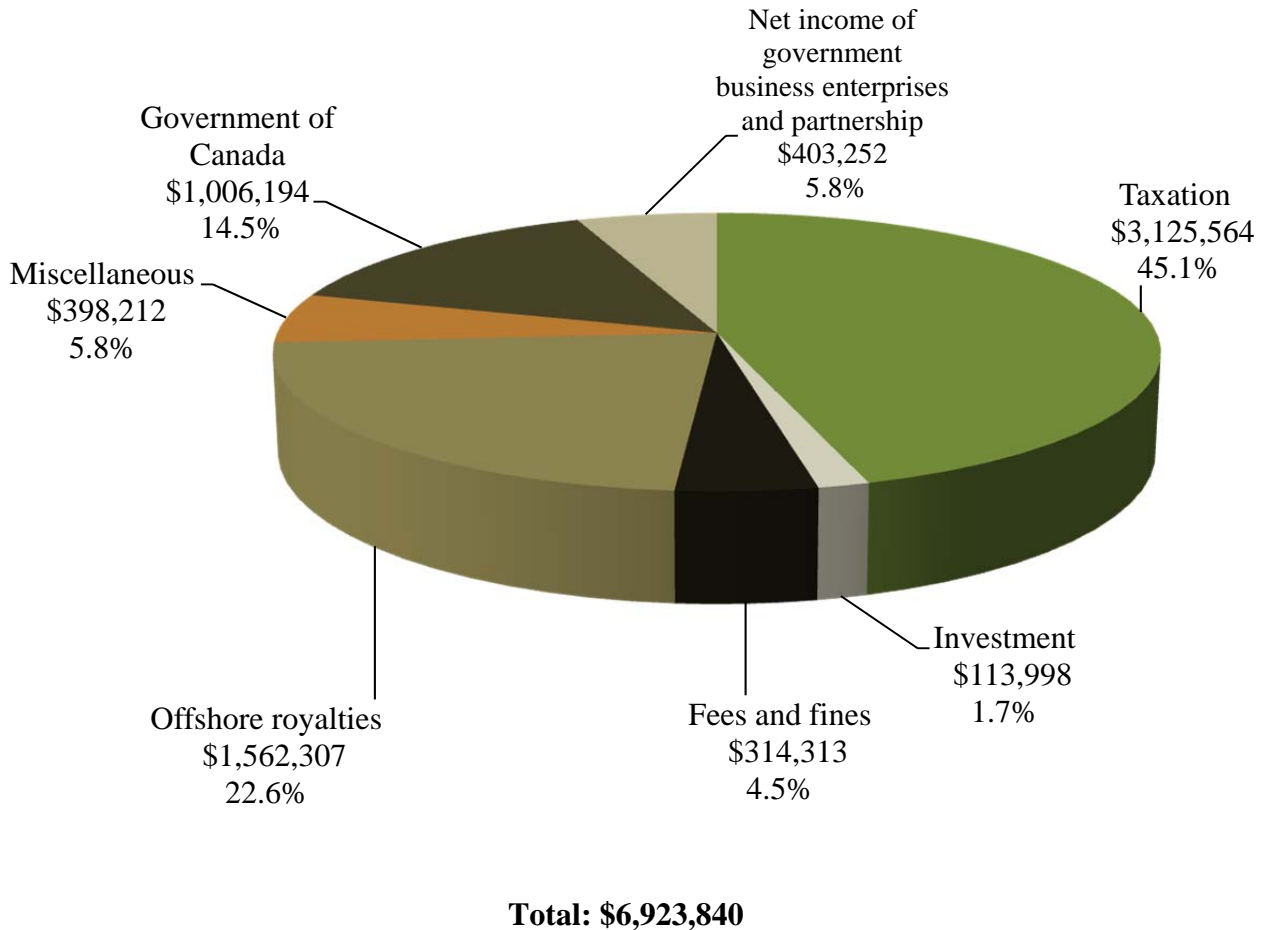
Consolidated Statement of Operations

This statement shows the results of the operations of the Government Reporting Entity for the year April 1, 2014 to March 31, 2015, 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, 2015. Approximately 23% of the Province’s total revenues came from offshore royalties.

Chart 3

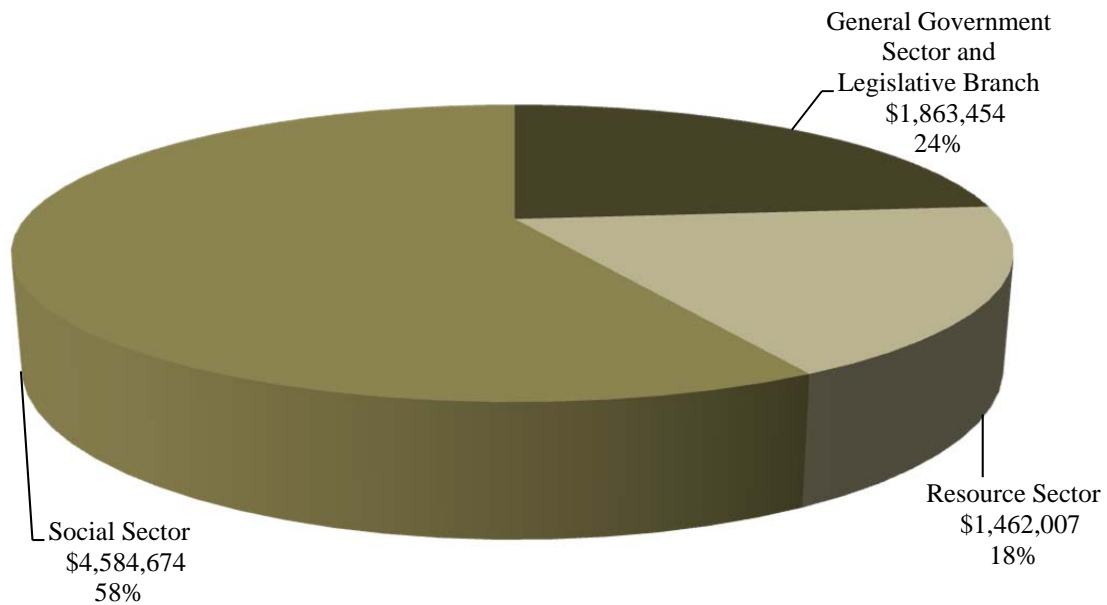
**Consolidated Summary Financial Statements
Revenues by Source
Year Ended March 31, 2015
(\$000s)**



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, 2015. Approximately 58% of the Province's total expenses of \$7.9 billion were spent in the social sector.

Chart 4

Consolidated Revenue Fund Financial Statements
Expenses by major functional area
Year Ended March 31, 2015
(\$000s)



Total: \$7,910,135

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 \$986 million for the year ended March 31, 2015 (2014 - \$389 million 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, 2015, 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.
- Adoption of the new accounting standard related to Contaminated Sites, which was applied retroactively without restatement.

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.

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APPENDIX

I

**ANSWERS TO FREQUENTLY ASKED QUESTIONS
ABOUT THE PUBLIC ACCOUNTS**

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

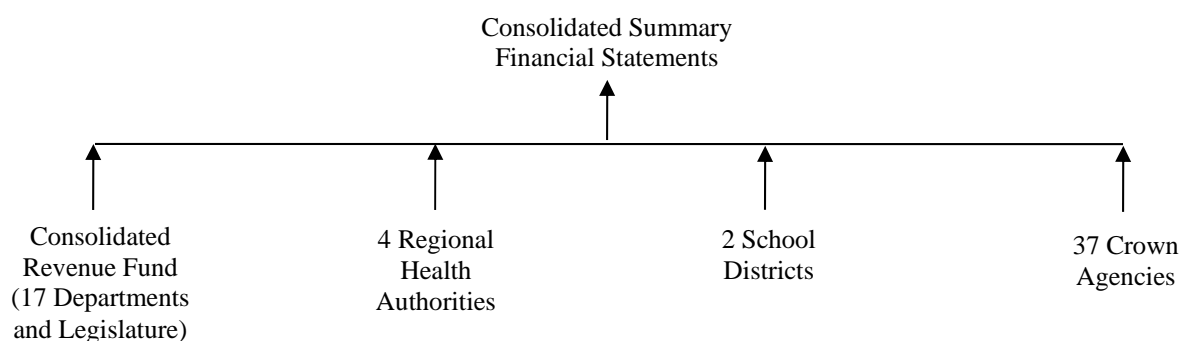
The Public Accounts of the Province of Newfoundland and Labrador for the year ended March 31, 2015, consists of the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador. The Consolidated Summary Financial Statements are prepared on the accrual basis of accounting in 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 17 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, 2015



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.

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**APPENDIX
II
GLOSSARY**

Glossary

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). <i>In this report, GDP information is obtained from the Department of Finance, and is not adjusted for inflation unless otherwise indicated.</i>

Glossary

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.

