



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, 2017**

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.

Office Location

7 Pippy Place
St. John's
Newfoundland and Labrador
Canada
A1B 3X2

Mailing Address

P.O. Box 8700
St. John's
Newfoundland and Labrador
Canada
A1B 4J6
Telephone: (709) 729-2700
Email: oagmail@oag.nl.ca
Website: www.ag.gov.nl.ca/ag



**AUDITOR
GENERAL**
of Newfoundland and Labrador

October 2017

The Honourable Perry Trimper, M.H.A.
Speaker
House of Assembly

Dear Sir:

In compliance with the *Auditor General Act*, I have the honour to submit, for transmission to the House of Assembly, my Report on the Audit of the Financial Statements of the Province of Newfoundland and Labrador for the year ended March 31, 2017.

Respectfully submitted,

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TERRY PADDON, CPA, CA
Auditor General

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**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, 2017, and comments on the risks and challenges the Province faces when considering the information provided in Budget 2017.

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

Acknowledgements

I acknowledge the cooperation and assistance my Office has received from the Office of the Comptroller General during the completion of 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 this year and over the past 5 1/2 years.

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

Introduction

CHAPTER

2

SIGNIFICANT OBSERVATIONS

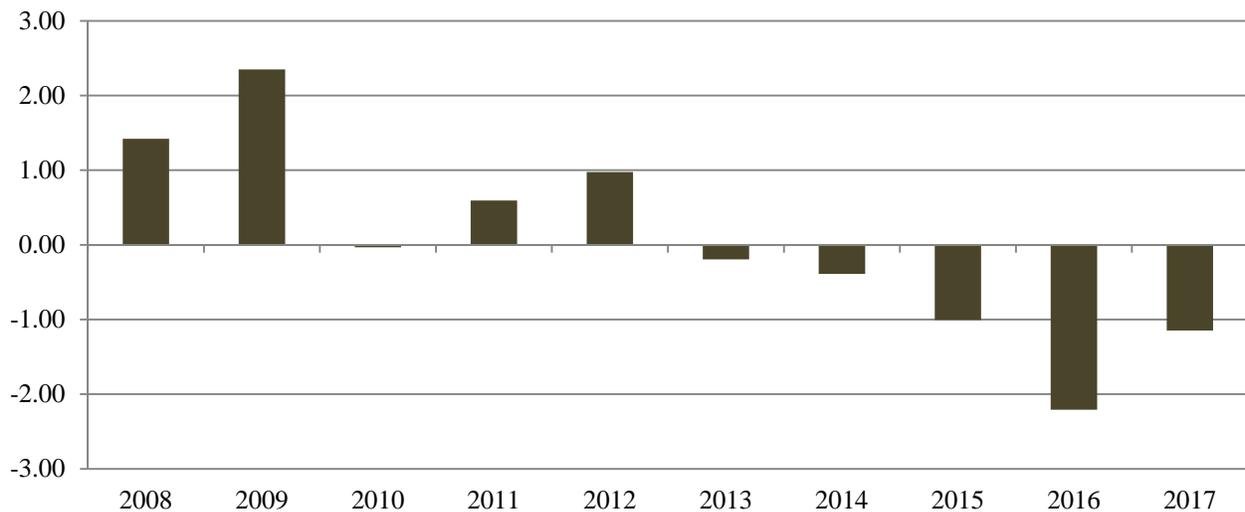
2016-17 Public Accounts

Deficit

The Province tabled the Public Accounts on October 6, 2017. The Consolidated Summary Financial Statements for the year ended March 31, 2017, shows a deficit for the year of \$1.1 billion.

Chart 1

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



Source: Public Accounts

Observation

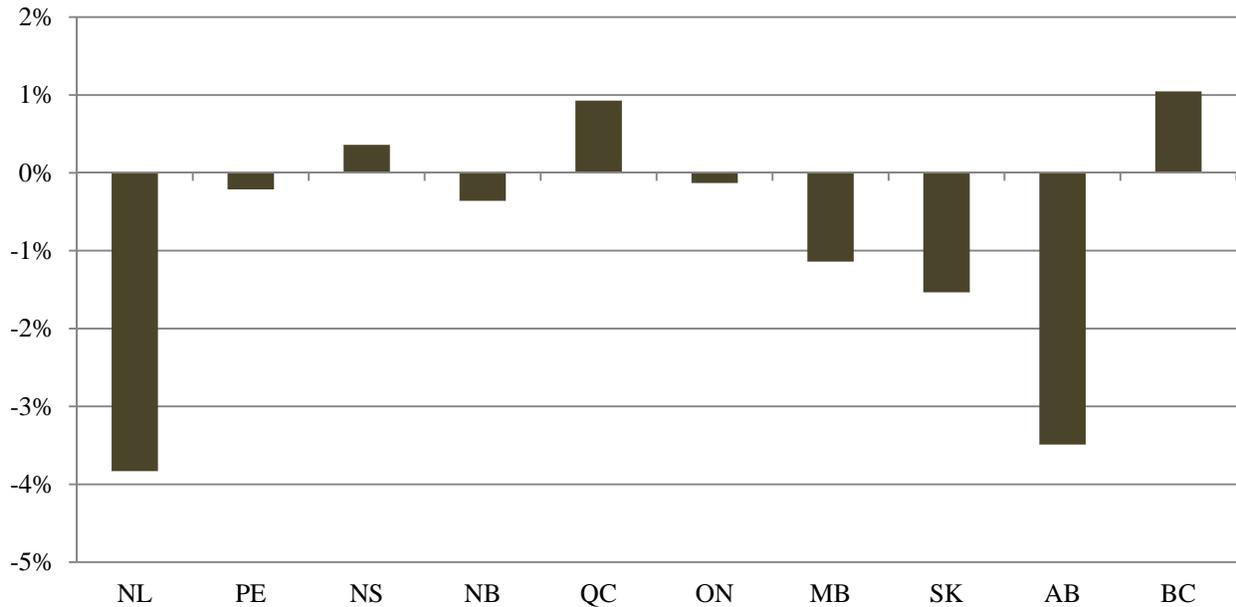
1. While the deficit for 2016-17 of \$1.1 billion has been reduced to almost half the deficit of the previous fiscal year, deficits of this magnitude are not sustainable.

Deficit as a Percentage of GDP

The absolute amount of the deficit is an important indicator of financial performance, but a more informative indicator is 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.

Chart 2

**Provincial Comparison
Surplus/Deficit as a Percentage of GDP
Year Ended March 31, 2017**



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

Observation

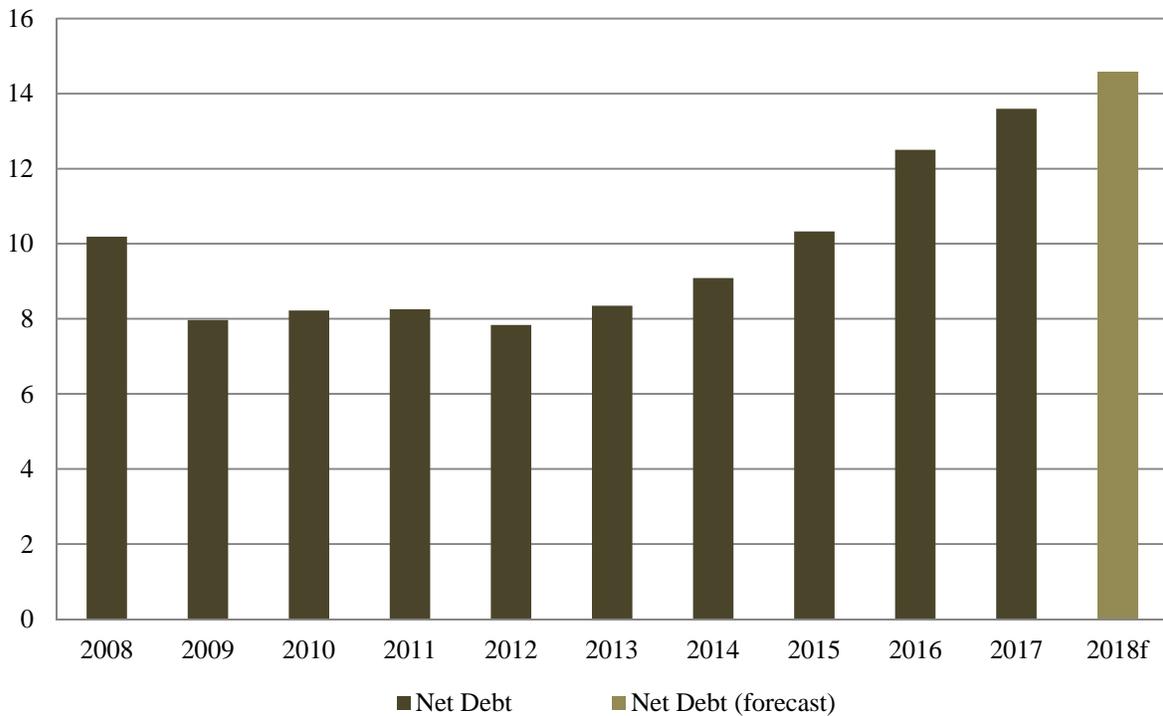
2. The deficit as a percentage of GDP in Newfoundland and Labrador for 2016-17 is 3.8% - the highest in Canada and substantially higher than most other provinces.

Net Debt

Net Debt at March 31, 2017 amounts to \$13.6 billion, the highest level in the history of the Province. The Province is forecasting that Net Debt will reach \$14.6 billion by March 31, 2018.

Chart 3

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



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

Observation

- Net Debt at March 31, 2017 amounts to \$13.6 billion, the highest level in the history of the Province. The Province is forecasting that Net Debt will reach \$14.6 billion by March 31, 2018.

Balancing the Budget

In order to move from the current financial circumstance which has the Province incurring expenses annually that are \$1.1 billion greater than the revenue available to pay for those expenses, either revenue has to increase, in a sustainable manner, or expenses have to decrease.

In Budget 2017, the Province laid out a plan which, they hope, will achieve a surplus by 2022-23.

Significant Observations

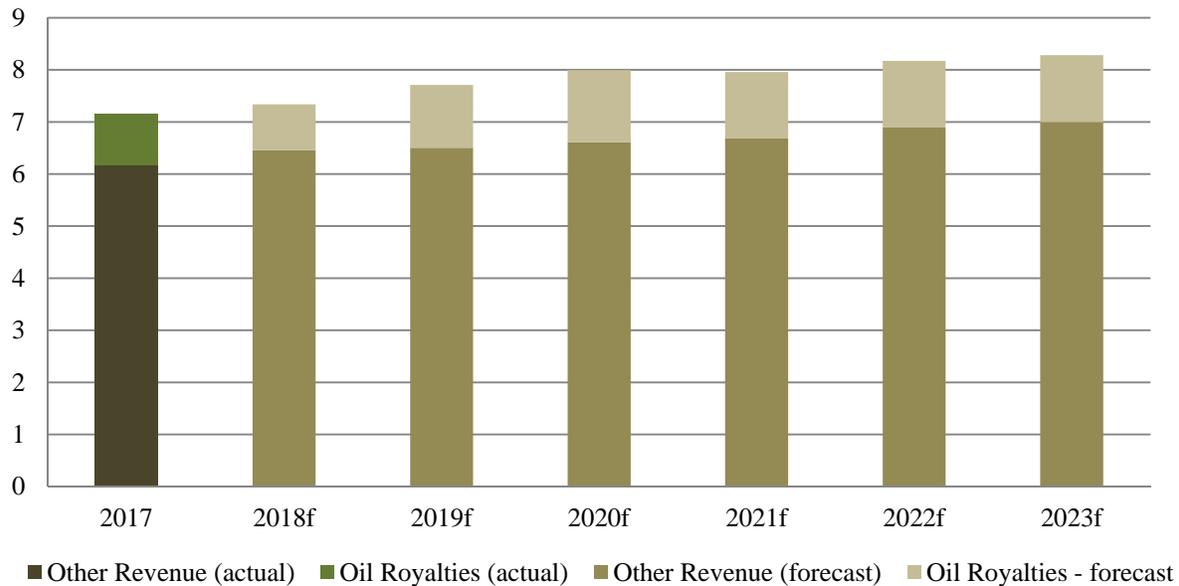
Revenue

The 2016-17 Public Accounts shows an increase in revenue from the previous year. The increase largely results from increased taxes, primarily the result of the full impact of tax measures announced in the previous year, and an increase in oil royalties, primarily the result of increased production. Oil royalties represent about 14% of total revenue, a significant drop from 34% in 2011-12.

Revenue over the six year period to 2022-23 is forecast by the Province to grow by \$1.1 billion.

Chart 4

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



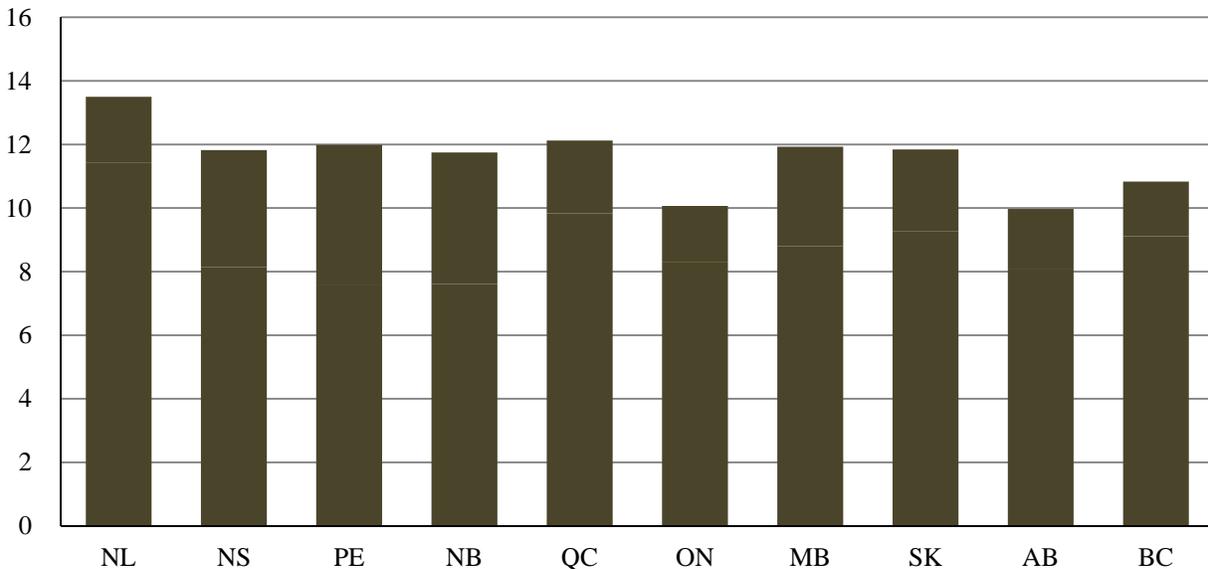
Source: Public Accounts (actual); Department of Finance (forecast)

Almost 27% of this growth is expected from oil (predominately increased oil prices) and the remaining 73% from other sources (including expected profit from Muskrat Falls).

Looking at the Province's revenue per capita provides a basis for comparing revenue generation in Newfoundland and Labrador with other provinces.

Chart 5

**Provincial Comparison
Per Capita Revenue
Year Ended March 31
(\$ 000s)**



Source: Public Accounts - all provinces; Statistics Canada

Observation

4. The Province of Newfoundland and Labrador generates more revenue, on a per capita basis, than every other province.

This suggests that revenue is not the primary issue creating the deficits.

Expenses

The 2016-17 Public Accounts shows a reduction in program expenses of \$68 million from the previous year. However, since 2007-08 program expenses have grown by \$2.4 billion – representing cumulative growth over that period of 47.9%.

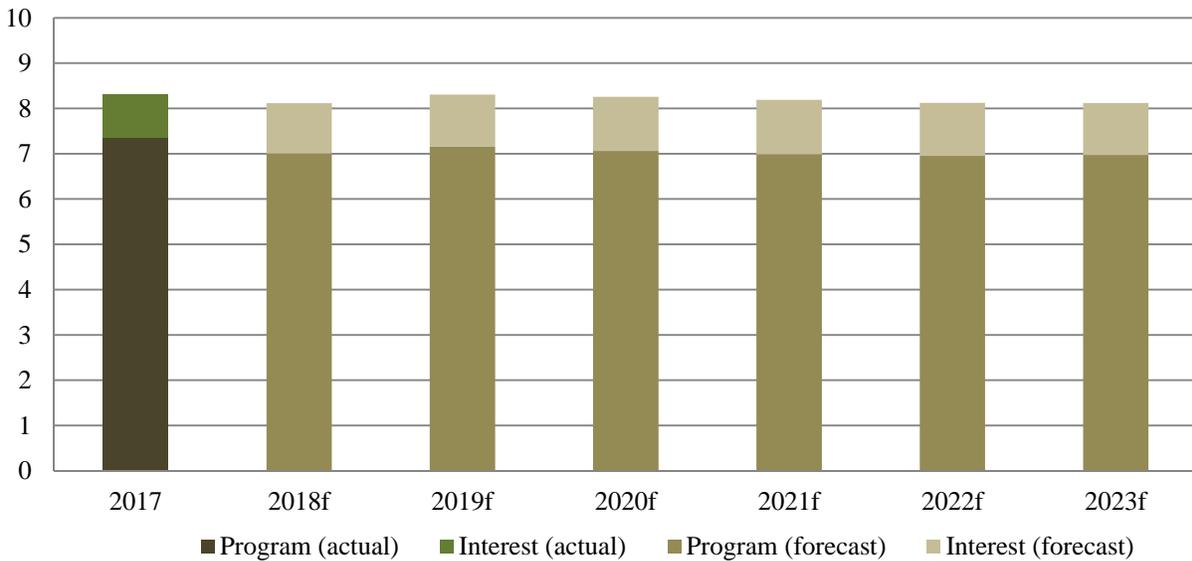
Debt expenses increased in 2016-17 by \$54 million from the previous year to \$956 million - primarily the result of increased borrowing. Money allocated to servicing debt is money that is not available to fund programs and services. Debt expenses as a percentage of revenue has increased overall since 2008 and is at 13.4% for 2016-17.

Significant Observations

The Provincial forecast for the period 2017-18 to 2022-23 expects expenses to drop by 2.3% over that period.

Chart 6

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



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

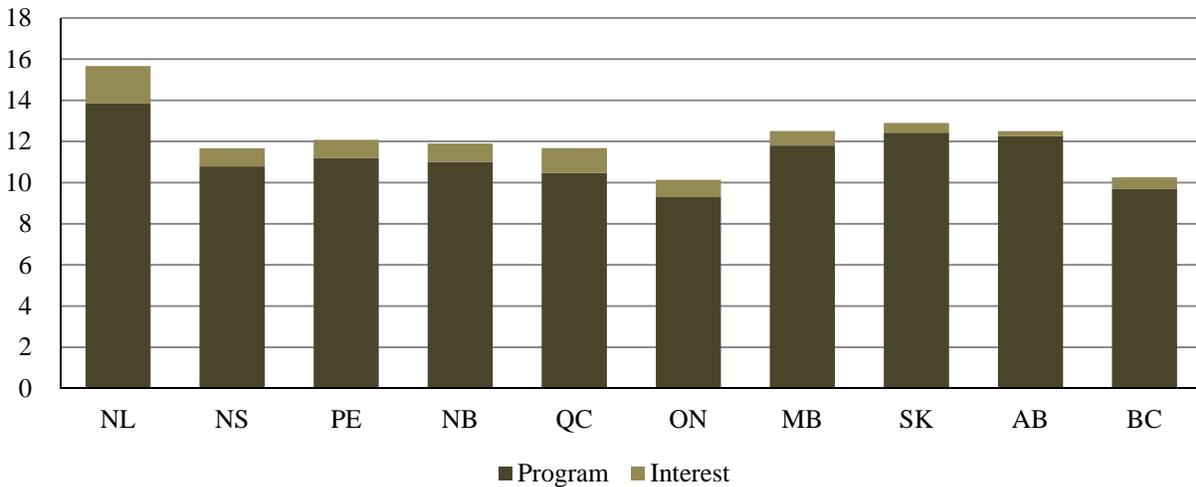
Observation

5. Expenses over the six year period to 2022-23 are forecast by the Province to reduce slightly by \$187 million - a 2.3% decline.

While, on a per capita basis, Newfoundland and Labrador generates more revenue than every other province, per capita spending in this Province is substantially higher than per capita revenues and we spend more than every other province by a considerable margin.

Chart 7

**Provincial Comparison
Per Capita Expenses
Year Ended March 31
(\$ 000s)**



Source: Public Accounts - all provinces; Statistics Canada

Observation

6. Newfoundland and Labrador spends in excess of 21% more per capita than the next highest province - Saskatchewan.

This suggests that the level of spending in the Province is the primary issue creating the deficits.

Risks to Achieving a Balanced Budget

A budget forecast involves making reasonable estimates based on realistic assumptions regarding expectations of future outcomes. The longer the forecast period, the greater the risk that expected outcomes may be significantly different than expected.

The six year revenue forecast to 2022-23 is based on assumptions regarding such items as oil prices, oil production, exchange rates and future economic activity in a variety of sectors of the economy.

While it is possible that the forecast may be exceeded, there is considerable risk that the revenue forecast may not be achieved.

- Oil royalties may be less than expected as a result of:
 - Lower than expected oil prices
 - Lower than expected production

Significant Observations

- Other tax revenue may be negatively impacted by a slowing economy
- Muskrat Falls revenue may be impacted by:
 - Further cost overruns and/or schedule delays
 - Any rate mitigation strategy which may be implemented by the Province

The six year forecast of expenses assumes a slight decline over the period. Keeping expenses at these forecast levels will be challenging.

- The expense forecast does not cover inflation which will erode service level delivery in an already challenging environment.
- There will be increased spending pressures as a result of changing demographics and other cost drivers.

Closing the Gap

The Province is forecasting a return to a balanced budget if:

- oil prices increase,
- production increases,
- economic activity occurs as predicted, and;
- spending is constrained over the period.

If this does not occur, the Province will have to look to other means to move to a balance.

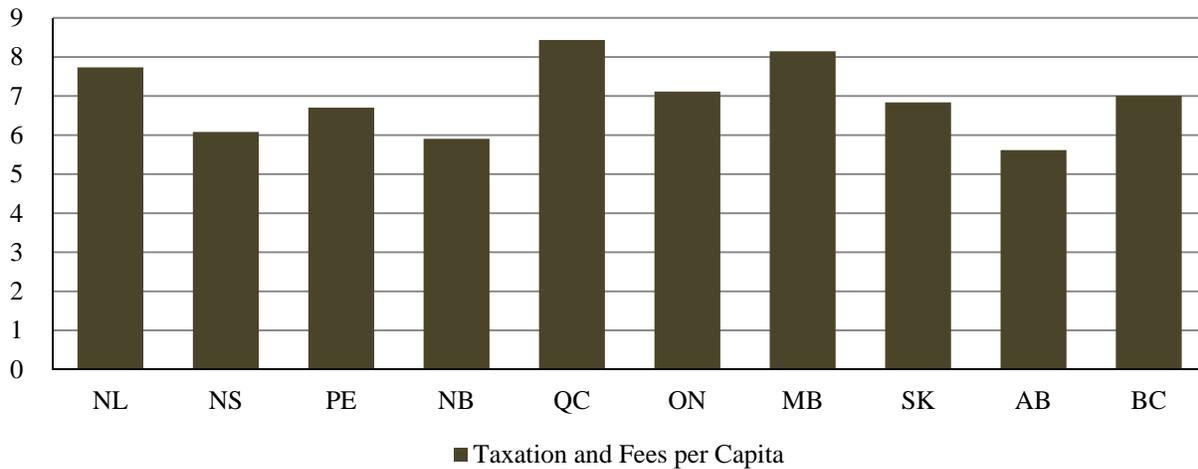
Closing the budget gap would require either more revenue, less expenses or a combination of both.

Revenue

The Province increased a number of taxes in Budget 2016. Currently, on a per capita basis, this Province has one of the highest tax burdens in the country.

Chart 8

**Provincial Comparison
Per Capita Taxes and Fees
Year Ended March 31
(\$ 000s)**



Source: Public Accounts - all provinces; Statistics Canada

Observation

7. Taxes and fees in Newfoundland and Labrador would have to increase, on average, by 28%, if these were the only means available to eliminate the 2016-17 deficit of \$1.1 billion. This would result in this Province having the highest tax burden in Canada.

Expenses

In the absence of significant additional tax increases, expenses would have to reduce to achieve a balanced budget.

Arguably, if Newfoundland and Labrador is spending so much more per capita than all other jurisdictions in Canada, we might expect that we have the highest level of public services in the country. Anecdotally, this does not seem to be the case.

The Province is challenged to afford the services that are currently being provided and there is continuing pressure for enhanced spending on existing services and for additional spending in new areas.

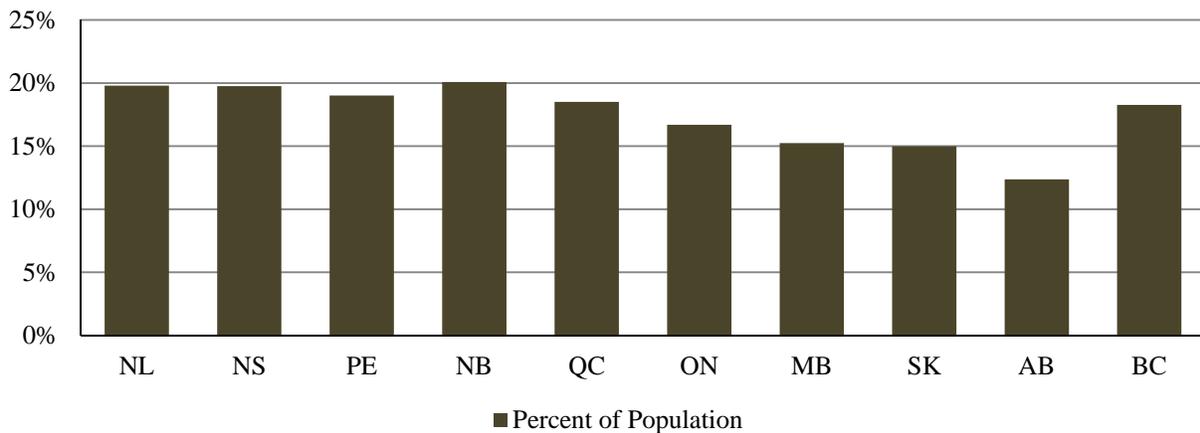
This suggests a more fundamental, structural, problem in the Province. Why, if Newfoundland and Labrador spends substantially more per capita than every other province in Canada, is there such a challenge to provide public services?

Older Population

The Province has an older population, similar to the Maritime Provinces and older than the rest of Canada. Almost 20% of the population of the Province is older than age 64.

Chart 9

Provincial Comparison Percentage of Population Age 65 and Over July 31, 2017



Source: Statistics Canada

Observation

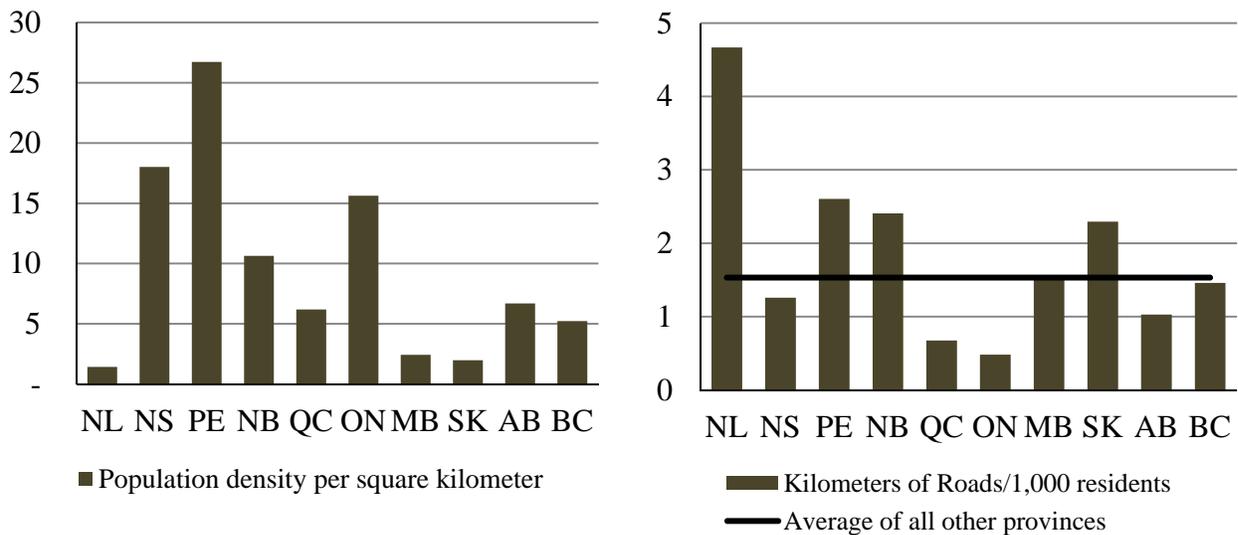
8. An older population would be a contributing factor to higher demand for public services.

Geography

The Province’s geography is also a contributing factor to a higher cost of delivering services.

Chart 10

**Provincial Comparison
Geographic Indicators
July 31, 2017**



Source: Statistics Canada (population); Transport Canada (road statistics)

Newfoundland and Labrador has the sparsest population of any province in Canada. However, the density of the population alone is not necessarily an indicator of service delivery challenges.

The number of kilometers of roads per person provides an indicator of how spread out our population is and the associated impact of being able to delivery services in an efficient and economical manner. Newfoundland and Labrador has approximately 3 times the number of kilometers of roads per person than the average of all other provinces.

These factors would have a considerable impact on the cost of delivering public services in this Province.

Observation

- 9. A sparse population, spread out over a large land mass, creates challenges to providing efficient, economical public services.

Summary

The current, medium-term, forecast of the Province anticipates a surplus in 2022-23. Realizing this milestone is dependent on the forecast assumptions being achieved.

Considerable risk surrounds achieving the targets. Oil prices may not rise to expected levels by 2022-23, expected levels of oil production may not be achieved and a slowing economy may impact growth in tax revenues. Additionally, the Province's forecast of expenses shows an expected decline over the period of \$187 million. Holding expenses to the forecast levels will be challenging given current demands and the impact of expected future demands resulting from such things as demographic change. Any rate mitigation strategy which may be implemented to offset higher electricity rates due to Muskrat Falls, would also presents a risk to the forecast.

The Province generates more revenue per capita than other province and has one of the highest tax burdens. This suggests there may be limited opportunity to generate significant additional revenue from taxation in the event the Province falls short of its balanced budget target.

The Province also spends more per capita than every other province. Any further expenditure reductions which may be required to achieve budget targets will necessarily have to consider hard choices around the types of services provided, where those services are provided and how those services are delivered.

Lower Churchill Project

Overview

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

The Project is currently expected to cost \$12.7 billion, including interest during construction/pre-funded financing costs of \$2.6 billion. This represents an increase of \$5.3 billion from the expected cost when it was sanctioned. As of June 30, 2017, Nalcor Energy and/or its subsidiaries had spent \$7.9 billion related to the Project and had contractual commitments to spend a further \$1.6 billion.

A portion of the Project has been financed through an issuance of bonds of \$7.9 billion by Nalcor Energy project subsidiaries. The bonds are fully guaranteed by the Government of Canada. The Province has also provided a guarantee to the Government of Canada to compensate it for any costs under this Guarantee that are triggered by legislative or regulatory actions of the Province. The remaining cost of \$4.8 billion is expected to be financed through equity contributions from the Province and Nalcor Energy, as well as Emera, which has a minority partnership interest in the Labrador-Island Link.

Significant Observations

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

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

The business model for the Project included an expectation that the taxpayers of Newfoundland and Labrador would recover the equity used to finance the Project plus a return on that equity. The recovery of equity and any potential return will be dependent on the electricity rates imposed on ratepayers after the Project comes into service. Higher electricity rates result in a higher return for taxpayers on their investment in the Project. Lower rates will result in a lower return for taxpayers but would benefit ratepayers.

Observation

10. The Province and Nalcor Energy will have to balance the competing interests of taxpayers and ratepayers as they determine an appropriate electricity rate structure in Newfoundland and Labrador.

Potential Impact on the Province's Financial Statements

Under Public Sector Accounting Standards, Nalcor is considered a Government Business Enterprise (GBE). A GBE is a crown corporation whose operations are commercial in nature and self-sustaining. The debt of GBEs is fully supported by its customers – in the case of the electrical generation and distribution business of Nalcor, the rate-payers.

Because of the self-sustaining nature of a GBE (customer supported vs. taxpayer supported), the accounting treatment of a GBE in the Public Accounts is different than that of a Crown entity which is supported by taxpayers. In essence, the debt of a GBE is not explicitly shown on the Public Accounts. The debt is offset by the asset which generates the revenue to support the debt.

Each year, Government must assess the value of assets owned by the Crown, directly or through Crown corporations, regardless of whether they are a GBE or otherwise, to ensure there is no impairment in value. In simple terms, an asset of a GBE would be considered impaired if expected future revenues are less than the cost of the asset. If that were the case, the value of the asset would be reduced, resulting in an increase in the Provincial deficit and Net Debt.

Significant Observations

The existing Muskrat Falls business, regulatory and financing structure ensures costs, expenses or allowances related to the Project will be recovered, in full, from ratepayers in the Province. Because this structure ensures there will be sufficient revenue generated from ratepayers over the life of the project to cover the capital and operating costs of Muskrat Falls, it is unlikely that the Muskrat Falls assets would be considered impaired in value on the financial statements of Nalcor.

However, Government has indicated that it is examining options to mitigate the impact of expected electricity rate increases resulting from Muskrat Falls. There has been no decision on the type of mitigation, if any, or the amount.

The impact of any strategy to effectively reduce electricity rates will have to be evaluated to determine any potential impact on the Public Accounts of the Province. The Province will have to consider whether the substance of any mitigation strategy will, in effect, result in some portion of debt related to Muskrat Falls becoming taxpayer supported debt vs. ratepayer supported debt and, consequently, how that is reflected in the Public Accounts of the Province.

Observation

11. The Province will have to consider the impact on the Public Accounts of any electricity rate mitigation measure that may, in effect, recognize that some of the debt related to the Muskrat Falls project will be supported by taxpayers.

Timing of Release of Public Accounts

In order for financial statement information to be useful to users, it should possess four principle characteristics - understandability, relevance, reliability and comparability. One of the ways relevance is achieved is by ensuring the information is received by users and decision makers in a timely manner. The usefulness of information for decision making declines as time elapses.

Since 2012, the Office of the Auditor General (OAG) and the Office of the Controller General (OCG) have made considerable progress in concluding the audit of the Public Accounts earlier. With the exception of 2015, where timing was influenced by the general election, the Consolidated Summary Financial Statements have been available approximately six months after the year end.

Significant Observations

Table 1

**Audit Report Dates
Newfoundland and Labrador Public Accounts
Years Ended March 31, 2012 to 2017**

Year End	Audit Report Date	Number of Days After Year-end
March 31, 2012	January 4, 2013	279
March 31, 2013	December 30, 2013	274
March 31, 2014	October 10, 2014	193
March 31, 2015	January 4, 2016	296
March 31, 2016	October 14, 2016	197
March 31, 2017	September 29, 2017	182

Source: Public Accounts

While there has been progress, there is still room for improvement. A review of other jurisdictions in Canada indicates a range of audit report dates.

Table 2

**Audit Report Dates
Canadian Jurisdictions
Years Ended March 31, 2016 and 2017**

Jurisdiction	Audit Report Date	
	March 31, 2017	March 31, 2016
Newfoundland and Labrador	September 29, 2017	October 14, 2016
Nova Scotia	July 20, 2017	July 27, 2016
Prince Edward Island	Note	November 25, 2016
New Brunswick	August 22, 2017	September 27, 2016
Quebec	Note	October 19, 2016
Ontario	August 18, 2017	October 5, 2016
Manitoba	September 5, 2017	September 14, 2016
Saskatchewan	June 15, 2017	July 14, 2016
Alberta	June 29, 2017	June 22, 2016
British Columbia	August 22, 2017	July 4, 2016
Canada	September 6, 2017	September 6, 2016

Note: Financial statements not released as of October 18, 2017.

Source: Public Accounts – all provinces and Canada

Significant Observations

In 2017, the *Financial Administration Act* (the *Act*) was amended to require that the Public Accounts be tabled before November 1 of the following fiscal year. The previous date was February 1.

The *Act* was further amended to require that, in the year of a general election, the Public Accounts to be tabled no less than 15 days prior to the fixed election date, generally the 2nd Tuesday in October every four years. This would require the Public Accounts to be tabled in mid-September in the year of an election.

Both the OCG and the OAG are actively looking for opportunities to reduce the time required to prepare and audit the Public Accounts. Given that the earliest audit report date has been September 29, 2017, ensuring the legislated tabling requirements are met in an election year will require further improvements by both the OAG and the OCG.

One impediment to an earlier release date is the current provision in the *Act*, which requires that the books of the Province remain open for up to one month after the year end to facilitate processing certain transactions which relate to the previous year. This essentially means that the Province is one month late in starting to prepare the year-end financial statements, which has a corresponding impact on the timing of audit work.

This provision in the *Act* is a throwback to the days when the Province used a cash basis of accounting. The Province moved to full accrual accounting in the 1990s and the interplay between the Estimates process and accounting has not been brought up to date. Newfoundland and Labrador is the only province that follows this practice - which is unnecessary and an impediment to more timely release of the Public Accounts.

The Province should strongly consider amendments to the *Act* to reflect modern accounting and controllership practices.

Observation

12. There has been progress in improving the timeliness of the release of the Public Accounts. The Province should strongly consider amendments to the *Financial Administration Act* to facilitate further improvement to the timeliness of the release of the Public Accounts and to reflect modern accounting and controllership practices.

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, 2017, my Office became aware of matters addressed under Section 15(1) of the *Act*. I reported the following matters to the Minister of Finance on September 25, 2017:

- The Professional Services and Internal Audit Division (the Division) of the Department of Finance informed my Office that they were notified about an incident where an employee of the Department of Advanced Education, Skills and Labour is alleged to have forged a supervisor's signature on an Income Tax form. As a result, the employee was disciplined. The Department also completed a review of certain aspects of the employee's work and no issues were found.
- The Professional Services and Internal Audit Division (the Division) of the Department of Finance informed my Office that they were notified about a \$100 shortage in a cash float in the Crown Lands office of the Department of Fisheries and Land Resources. A review of this matter is in progress.
- The former Department of Fisheries and Land Resources informed my Office about concerns related to an inventory of Government assets in the Wildlife Division. My Office was requested, and accepted, a request to conduct a special review of the matter. My Office is currently undertaking its investigation. The matter has also been reported to the police.
- The Department of Transportation and Works informed my Office of the following matters:
 - The Department is currently conducting a review of tire purchases in Central Newfoundland for potential misappropriation of Government assets.
 - Two employees used their Government supplied travel card for personal purchases, which is a violation of the Travel Card Agreement. In one instance, the card was cancelled and the amount owing is being recovered from the employee through payroll deductions. The Department is also reviewing the matter further to determine if disciplinary action is required. In the other instance, an employee received 2 days suspension.
 - In December 2016, the Department received a call about a contractor receiving salt from the Department. The matter is under investigation by the police.

Significant Observations

- There were tools missing at one depot and fuel missing at another depot. Both instances are being investigated by the police.
- There was an instance of potential theft of gas at a depot by an employee. An internal investigation is still ongoing.
- There was an instance of theft of materials, such as crushed stone and salt, from a depot. The employee was terminated and the matter was not reported to the police.
- Two instances where employees did not report leave taken. In one instance, an investigation is ongoing and in the other instance the investigation resulted in no action being taken.
- Two instances where an employee misrepresented the reason for a leave request. In one case, a disciplinary letter was placed in the employee's file. In the other case, the investigation is still ongoing.
- One instance where an employee adapted Workplace Health and Safety Compensation Commission forms. No action was taken due to a lack of evidence.

Also, I reported the following matters to the Minister of Finance on October 13, 2017, as a result of information received from Executive Council during the audit of the Public Accounts:

- An employee of Executive Council responsible for the attendance records was not recording paid leave for all of their own time off. When this issue was identified, action was taken in accordance with human resource policy.
- An inventory discrepancy was identified in Executive Council. This matter was addressed in accordance with human resource and financial management policy. Additional concerns regarding inventory were also identified, but could not be substantiated.

During our audit of the financial statements of the Support Enforcement Division of the Department of Justice and Public Safety (Support Enforcement), my Office became aware of a possible fraud. In six instances, cheques which were potentially fraudulent cleared Support Enforcement's bank. Officials at Support Enforcement became aware of the six transactions and contacted its bank. It was determined that the six cheques were deposited using a mobile banking application and also deposited at a bank branch. The bank reimbursed Support Enforcement \$1,303. Support Enforcement referred the matter to the police for investigation. I reported this matter to the Minister of Finance on November 10, 2016.

**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, 2017, on the Province's financial condition and the results of its financial performance for the year then ended. Given the current weakness in commodity prices, these financial statements must also be viewed in the context of future expectations in order to get a more comprehensive picture of the financial condition of the Province.

Observation

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

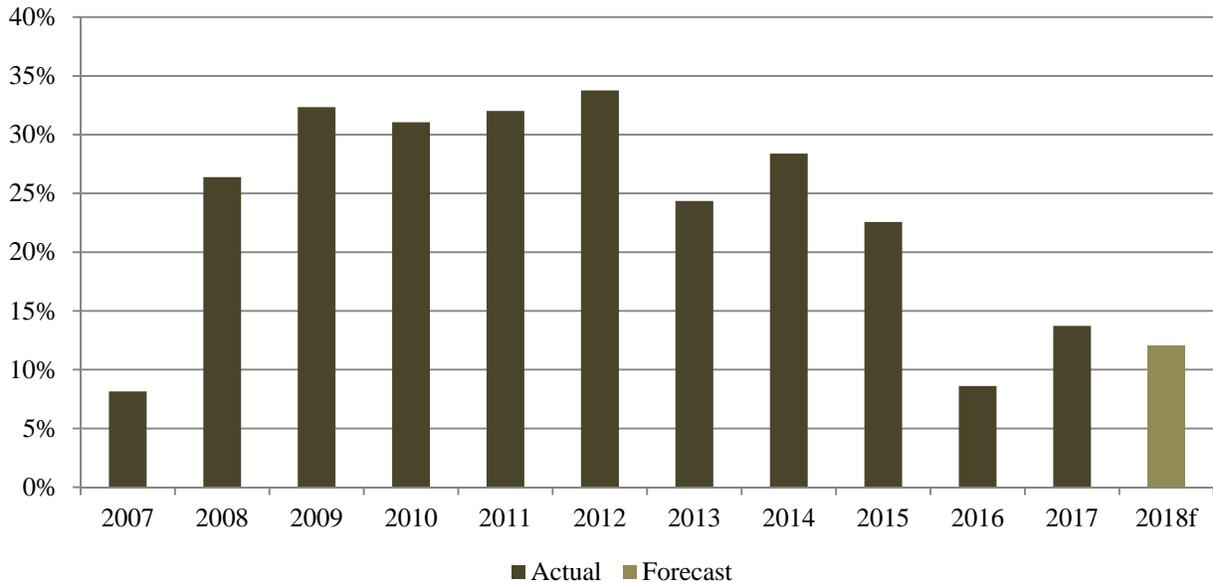
Overview

The weakness in commodity prices, particularly crude oil, continues to have a significant impact on the financial outlook of the Province of Newfoundland and Labrador.

From 2007-08 to 2015-16, the price of Brent crude averaged approximately \$US87 per barrel. In 2016-17, Brent crude had declined to an average of \$US49 per barrel. From April 2017 to September 2017, Brent crude increased slightly to an average of \$US51 per barrel. The consequence of such a dramatic and sustained reduction in oil prices has been a corresponding impact on the finances of the Province. From 2007-08 to 2015-16, oil royalties accounted for, on average, 27% of revenues, excluding Atlantic Accord revenues. By 2016-17, this had dropped to 14% and for 2017-18 the Province is projecting that oil royalties will only comprise 12% of government revenue.

Chart 1

**Province of Newfoundland and Labrador
Oil Royalties as a Percentage of Total Revenue
Years Ended March 31**



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

Observation

- From 2007-08 to 2015-16, oil royalties accounted for, on average, 27% of revenues, excluding Atlantic Accord revenues. By 2016-17, this had dropped to 14% and for 2017-18, the Province is projecting that oil royalties will only comprise 12% of government revenue.

This chapter provides an assessment of the financial condition of the Province using historical information drawn from the Public Accounts, as well as forecasted financial information for 2017-18 to 2022-23 obtained from Budget 2017 and other publicly available information.

Economic Outlook

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

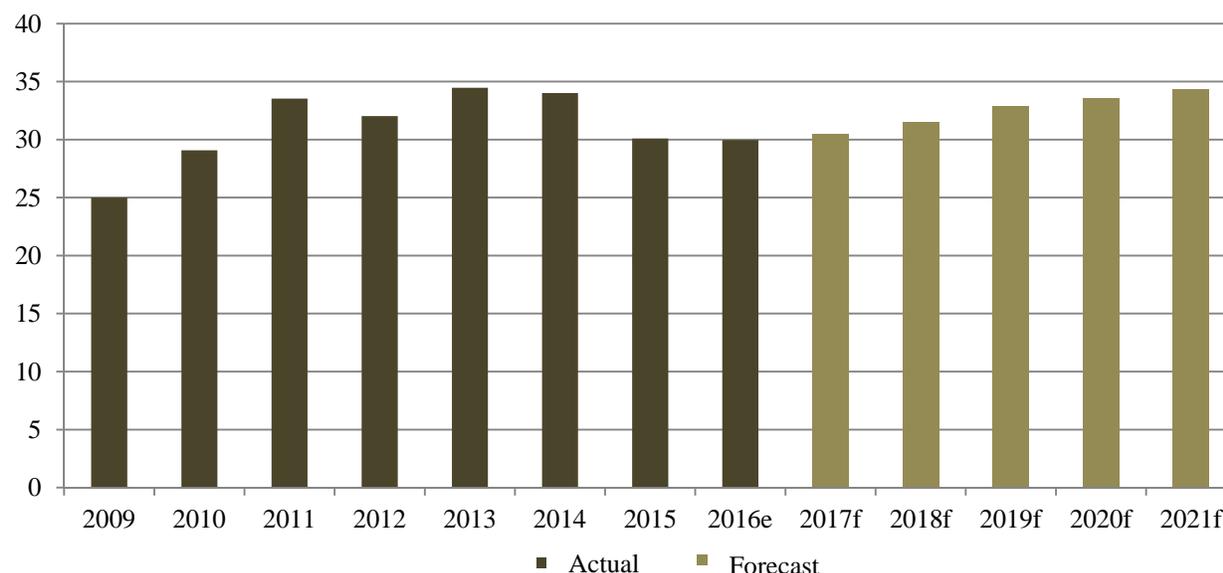
Gross Domestic Product

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

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

Chart 2

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



Source: Department of Finance

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

The Province's economic forecast for 2017 to 2021 indicates steady GDP growth, driven by anticipated increases in oil prices and oil production.

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

Observations

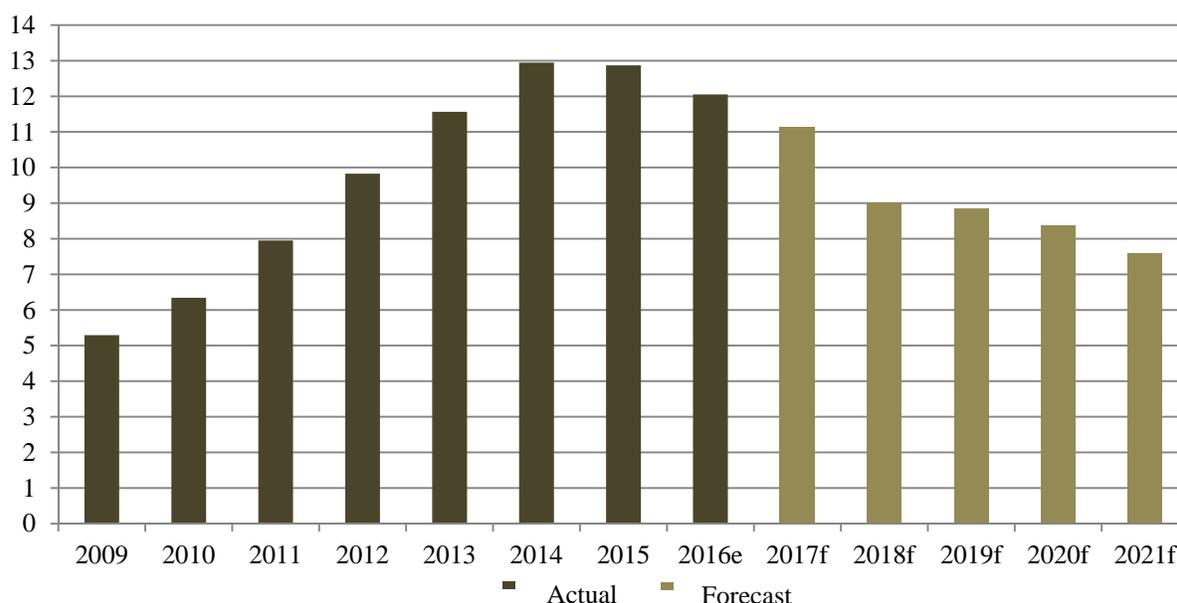
3. The Province's economic forecast is based on assumptions and future expectations and, like any forecast, is subject to considerable risk and change. Given that the economic forecast provides the basis for predicting taxation and other provincial revenues, this risk also extends to the Province's revenue forecast.
4. Nominal GDP is forecast by the Province to steadily increase from 2017 to 2021 based on increases in oil production and prices.

Capital Investment

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

Chart 3

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



Source: Department of Finance

The Province is forecasting significant declines in the level of capital investment from 2017 through 2021 as the construction phases of the Hebron and Muskrat Falls developments conclude. The potential of further provincial deficit reduction measures could also impact the level of capital investment in the Province. This decline in activity will have a corresponding drop in employment and will negatively impact revenue to the treasury from tax sources such as personal income tax and consumption taxes such as the HST.

Observations

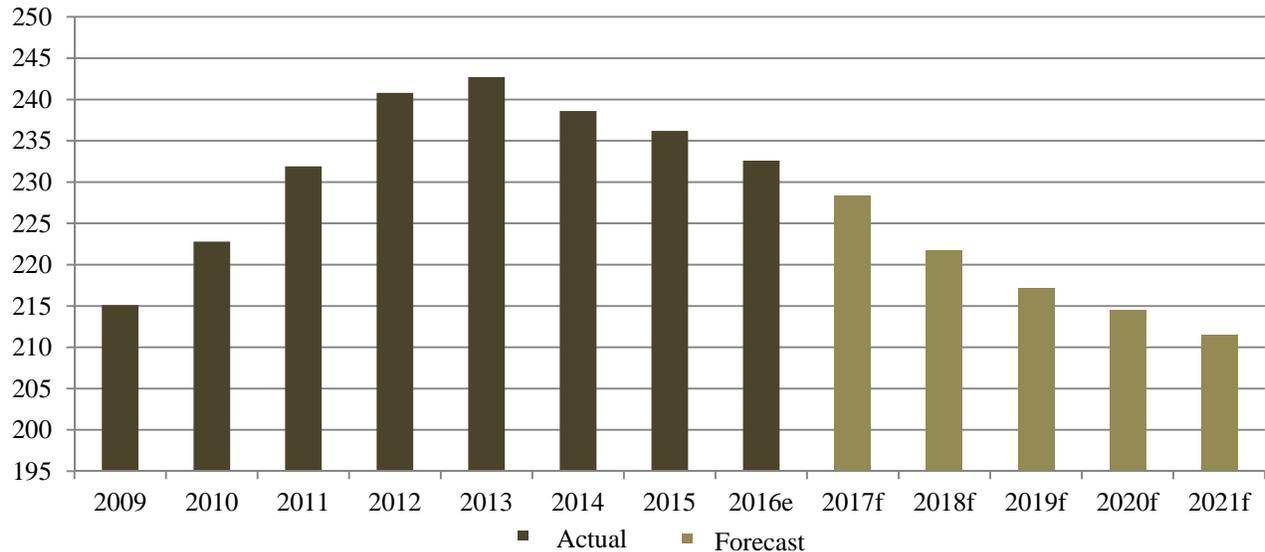
5. Large capital and labour intensive construction projects generate strong levels of employment and considerable benefits throughout the economy and to the treasury, but these benefits are time limited to the construction cycle.
6. Capital investment is expected to decline significantly from 2017 through 2021, which will have a corresponding negative impact on employment and revenue to the treasury.

Employment

Consistent with the decline in capital investment, the Province is also forecasting a significant decline in employment levels from 2017 through 2021. This will negatively impact personal income tax revenue and will also impact retail sales with an associated negative impact on HST revenue and other consumption taxes such as gasoline tax.

Chart 4

**Province of Newfoundland and Labrador
Employment
(Thousands)**



Source: Department of Finance

By 2021, the Province is forecasting employment to drop from the forecasted 228,300 persons in 2017 to 211,500 persons by 2021. This is a decrease of 16,800 persons over a four year period and a decrease of 31,200 from the high of 242,700 in 2013.

Observations

7. Employment is forecast to decline by 16,800 persons from 2017 through 2021 and decline by 31,200 from the high of 242,700 in 2013.
8. The forecast decline in employment will negatively impact personal income tax revenue and will also impact retail sales with an associated negative impact on HST revenue and other consumption taxes such as gasoline tax.

Surplus (Deficit)

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

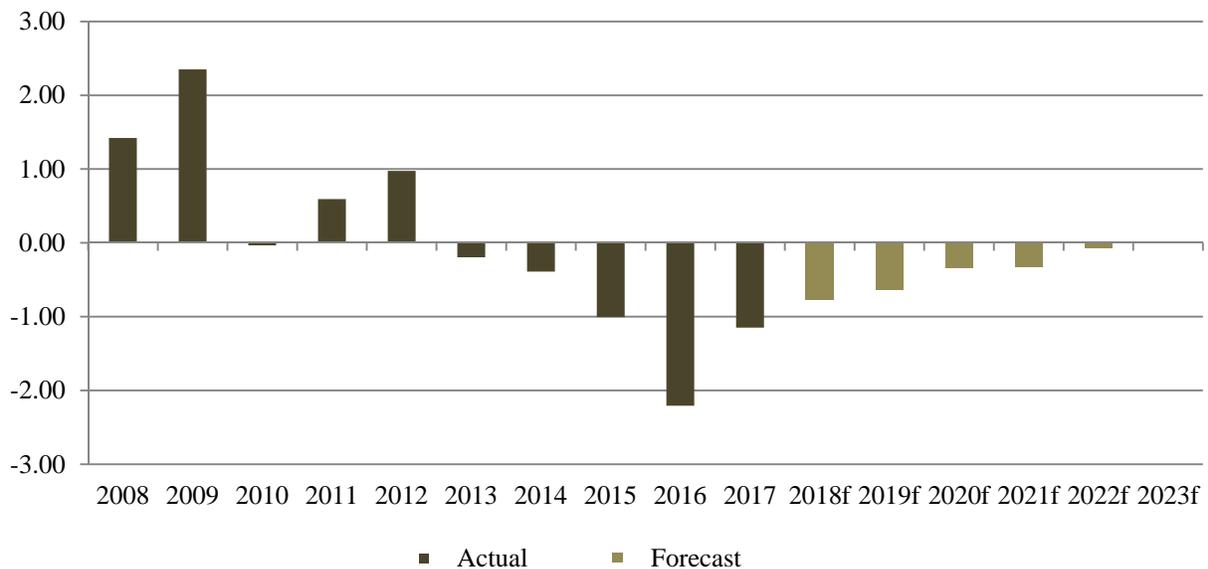
2016-17

For the year ended March 31, 2017, the Province recorded a deficit of \$1.1 billion. This is an improvement of \$0.7 billion from the amount predicted in Budget 2016.

The Province has recorded deficits in the past five consecutive years. The cumulative total of those deficits for these five years is approximately \$4.9 billion. While the deficit of \$1.1 billion recorded in 2016-17 represents a significant improvement over the deficit recorded in 2015-16, it is the second highest deficit ever recorded in Newfoundland and Labrador.

Chart 5

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



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

Observations

9. While the deficit of \$1.1 billion recorded in 2016-17 represents a significant improvement over the deficit recorded in 2015-16, it is the second highest deficit ever recorded in Newfoundland and Labrador.
10. The Province has accumulated deficits of approximately \$4.9 billion over the last five fiscal years.

Projected net deficit 2017-18 to 2022-23

Budget 2017 provided an estimate of projected surpluses and deficits to 2022-23. In the absence of any further intervention, the Province is forecasting deficits in each of the next five years, with a small surplus in year six. The projected net deficit for the years 2017-18 to 2022-23 is forecast to total \$2.1 billion.

Revenue is forecast to increase over the period by approximately \$1.1 billion, an increase of 15.7% - an average of 2.62% per year. The current forecast is based on an assumption of steadily increasing oil prices to 2022-23. There is risk that the forecast revenue growth may not be achieved.

Program expenses are forecast to decline by \$376 million over the same six year period – a decline of 5.1% or an average of 0.85% per year.

Observations

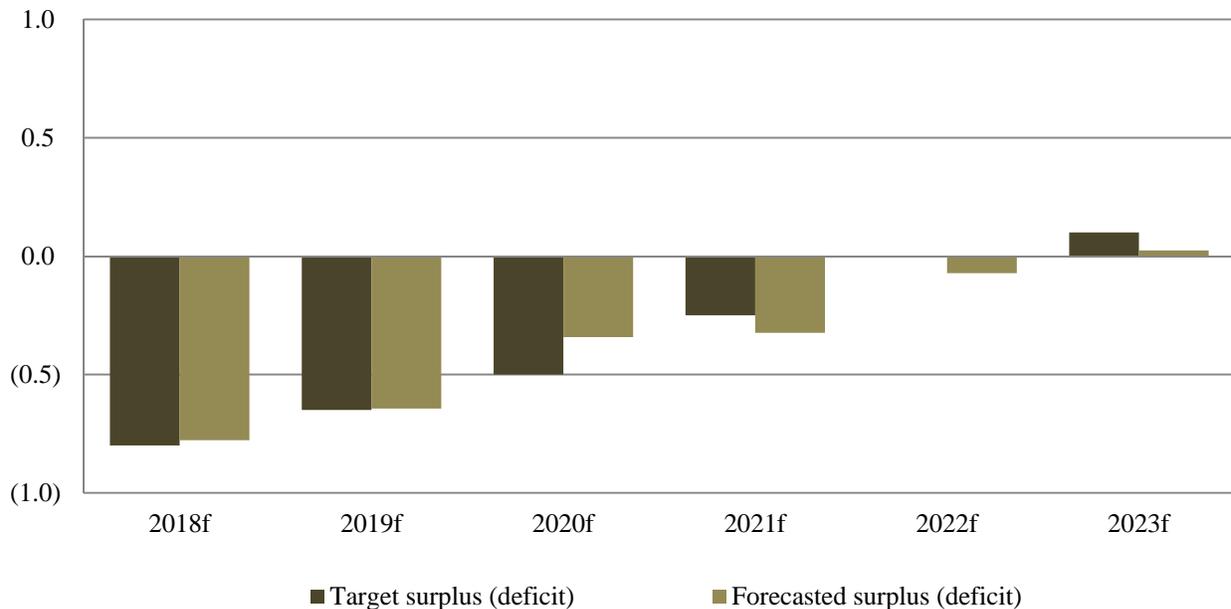
11. The projected net deficit for the years 2017-18 to 2022-23 is forecast to total \$2.1 billion.
12. Given that the current forecast is based on an assumption of steadily increasing oil prices up to 2022-23, there is risk that the forecast revenue growth may not be achieved.
13. Program expenses are forecast to decline by \$376 million over the same six year period – a decline of 5.1% or an average of 0.85% per year.

Deficit reduction targets

Budget 2016 initially outlined the Province’s deficit reduction targets and forecasted deficits to 2022-23. Budget 2017 further revised these forecasted deficits and now indicates that the Province will be close to achieving its deficit reduction targets.

Chart 6

**Province of Newfoundland and Labrador
Forecasted Deficits and Targets - Budget 2017
Years Ended March 31
(\$ Billions)**



Source: Department of Finance

There is still considerable risk that the Province will not achieve these forecasts. The expected increase in revenue relies primarily on the assumption of steadily increasing oil prices and oil production – factors outside of the Province’s control. Furthermore, the expense forecast may not be achieved because of inflationary and other pressures.

Observation

14. Budget 2017 indicates that the Province expects to come close to reaching its deficit reduction targets to 2022-23. However, there is still risk that revenues may not grow as expected and the Province may not be able to hold expenses at expected levels.

Deficit as a percentage of GDP

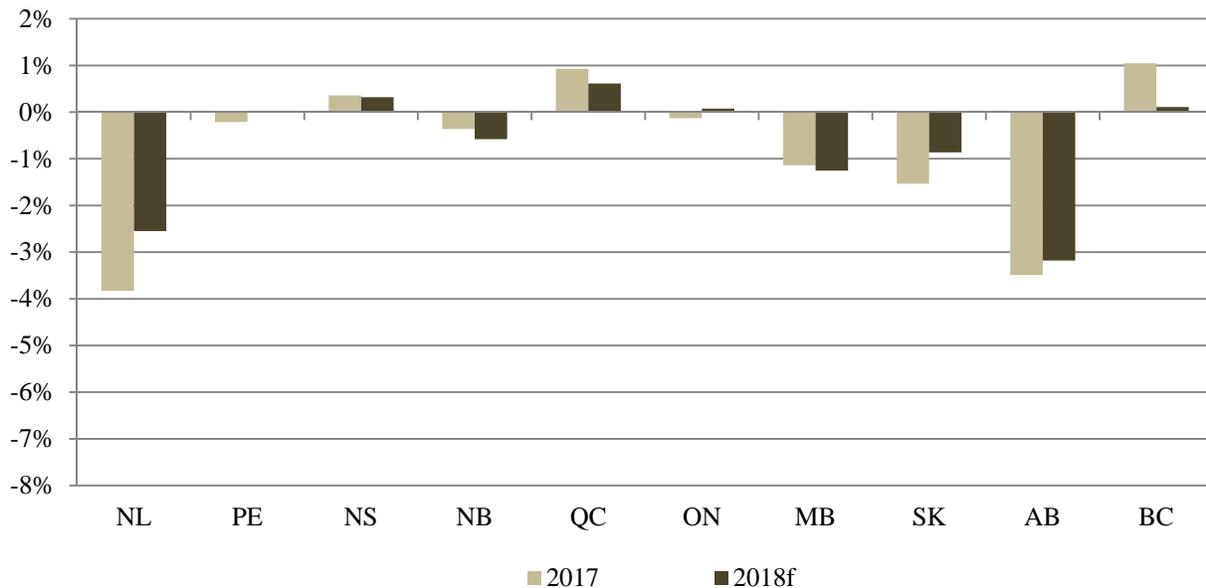
While the absolute amount of the deficit is an important indicator of financial performance, an additional, and more informative, indicator is to express the deficit as a percentage of GDP. This relates the deficit to the size of the Province’s economy and provides a basis for comparison of financial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

2016-17 and 2017-18

Seven provinces recorded deficits for 2016-17 and five are forecasting deficits for 2017-18.

Chart 7

**Provincial Comparison
Deficit as a Percentage of GDP
Years Ended March 31, 2017 and 2018**



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

Newfoundland and Labrador’s deficit as a percentage of GDP for 2016-17, at 3.8%, is the highest in Canada. The forecast deficit as a percentage of GDP for 2017-18 is expected to be 2.5% and would be the second highest in Canada.

Observations

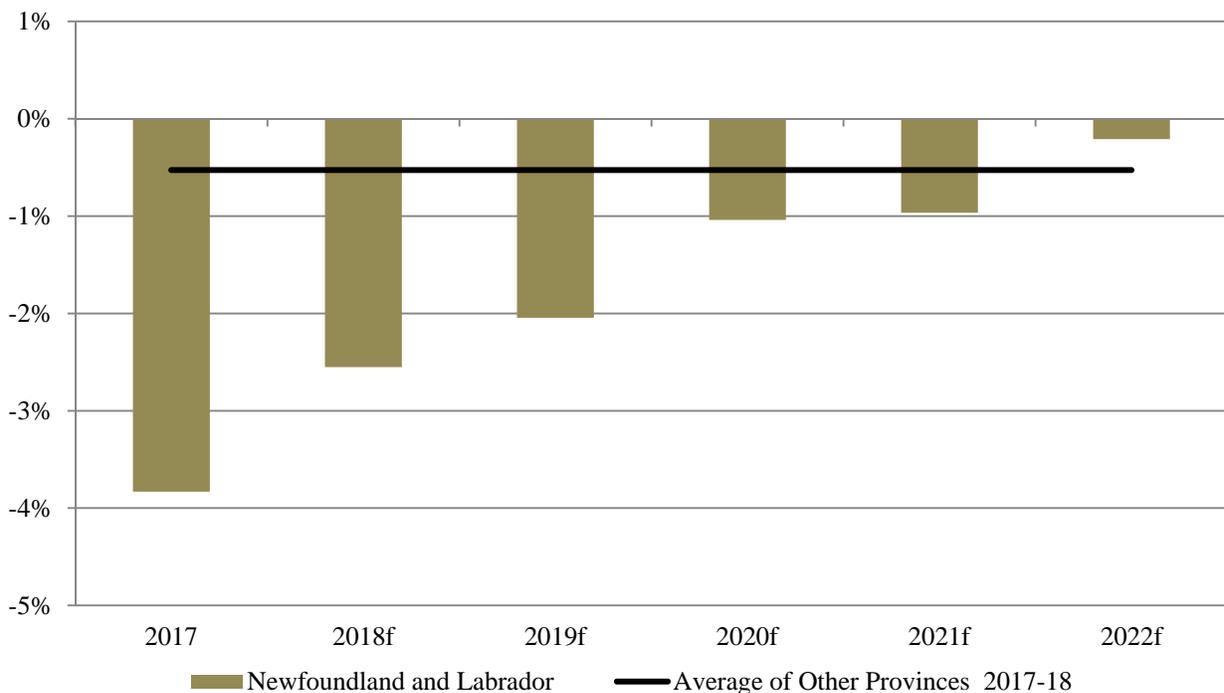
- 15. Newfoundland and Labrador’s deficit as a percentage of GDP for 2016-17 is 3.8% - the highest in Canada.
- 16. The forecast deficit as a percentage of GDP for 2017-18 is expected to be 2.5% - the second highest in Canada.

2017-18 to 2021-22

The forecast reduction in deficits to 2021-22 means that the Province’s relative deficit position will improve over that period. While the Province is predicting some growth in GDP over the period, the Province’s deficit to GDP ratio will still be significantly higher than the average of other provinces until 2018-19 and decline to the point of being lower by 2021-22 if the forecast is achieved. Considerable risk exists that the expected GDP growth could be less than forecast and the deficit could be higher than predicted.

Chart 8

**Province of Newfoundland and Labrador
Deficit as a Percentage of GDP
Years Ended March 31**



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

Observation

17. The Province’s deficit to GDP ratio will still be significantly higher than the average of other provinces until 2018-19 and decline to the point of being lower by 2021-22, if the forecast is achieved. Considerable risk exists that the expected GDP growth could be less than forecast and the deficit could be higher than predicted.

Net Debt

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

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

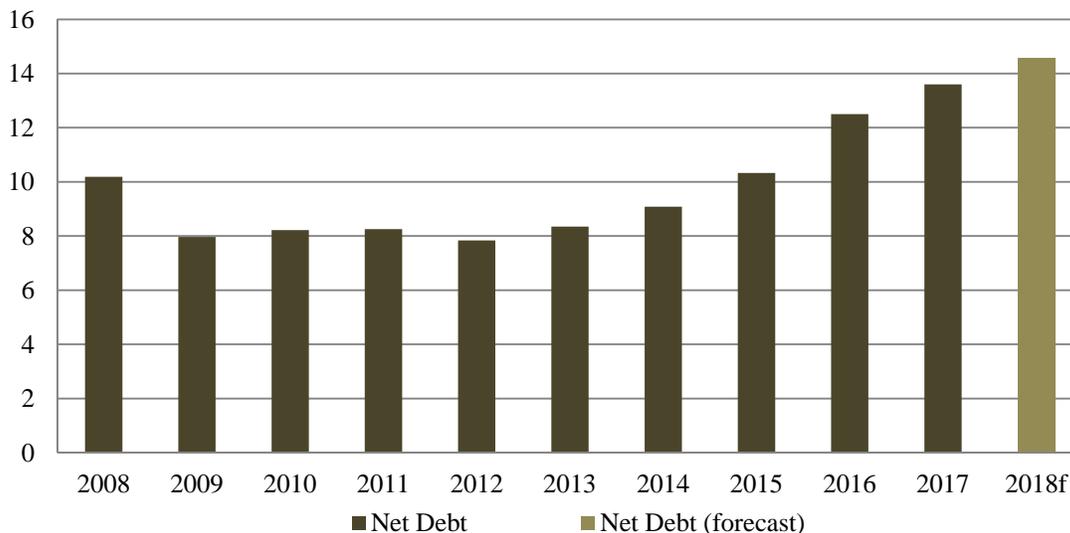
Financial assets are amounts that the Province has available to pay its liabilities or finance future operations. Financial assets consist of cash and temporary investments, amounts receivable from third parties, investments, inventories held for resale and equity in government business enterprises (GBEs)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

2016-17

Net Debt of the Province at March 31, 2017 was \$13.6 billion, an increase of \$1.1 billion from the previous year and the highest level in the Province’s history.

Chart 9

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



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

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

At March 31, 2017, Net Debt had increased by approximately \$5.8 billion from its low point in 2011-12, primarily the result of deficits totaling \$4.9 billion in the 2012-13 through 2016-17 fiscal years plus the impact of tangible capital asset acquisition during this period.

Observations

- 18. Net Debt of the Province at March 31, 2017, was \$13.6 billion, an increase of \$1.1 billion from the previous year and the highest level in the Province’s history.
- 19. At March 31, 2017, Net Debt had increased by approximately \$5.8 billion from its low point in 2011-12, primarily the result of deficits totaling \$4.9 billion in the 2012-13 through 2016-17 fiscal years plus the impact of tangible capital asset acquisitions during this period.

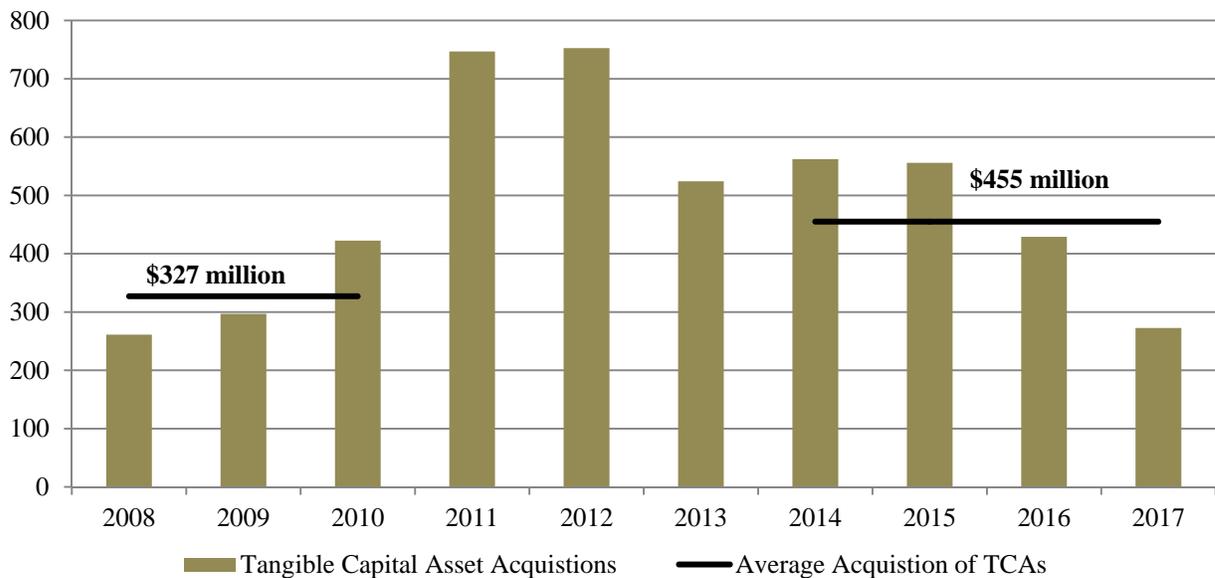
Tangible Capital Assets (Infrastructure)

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

Chart 10

**Consolidated Summary Financial Statements
Tangible Capital Asset acquisitions
Years Ended March 31**

(\$ Millions)



From 2008 through 2010, annual spending on tangible capital assets averaged \$327 million. Spending spiked after the recession of 2008 and 2009 as governments supported the economy through spending on infrastructure. The Province reduced infrastructure spending by \$156 million during 2017 and is now back to the pre-recession levels.

Any initiative designed to reduce the deficit and, by extension, control the growth in Net Debt will have to ensure the annual spending on new infrastructure in the Province is maintained at a reasonable level.

Observations

20. The Province reduced infrastructure spending by \$156 million during 2017 and is now back to the pre-recession levels.
21. Any initiative designed to reduce the deficit and, by extension, control the growth in Net Debt will have to ensure the annual spending on new infrastructure in the Province is maintained at a reasonable level.

2017-18 to 2022-23

The Province is forecasting a deficit of \$778 million in 2017-18. This will increase the Province's Net Debt to \$14.6 billion at March 31, 2018, the highest level of Net Debt in the Province's history.

The Province is expecting cumulative net deficits of \$1.3 billion from 2018-19 through 2022-23. This net deficit, combined with spending on infrastructure over the period will further increase Net Debt. There is insufficient detail provided in Budget 2017 to be able to assess the level of expected Net Debt by 2022-23.

Over the period 2017-18 to 2022-23, the Province expects to borrow \$5.0 billion in the capital markets. This borrowing will be used to:

- Re-finance existing debt as it comes due.
- Make the required payments under the promissory notes issued as part of changes made to the public service and teachers' pension plans.
- Finance deficits and infrastructure acquisitions.
- Fund the Province's currently expected share of equity for the Muskrat Falls project. Any additional cost overruns on the Muskrat Falls project would require additional equity and borrowings by the Province.

Observations

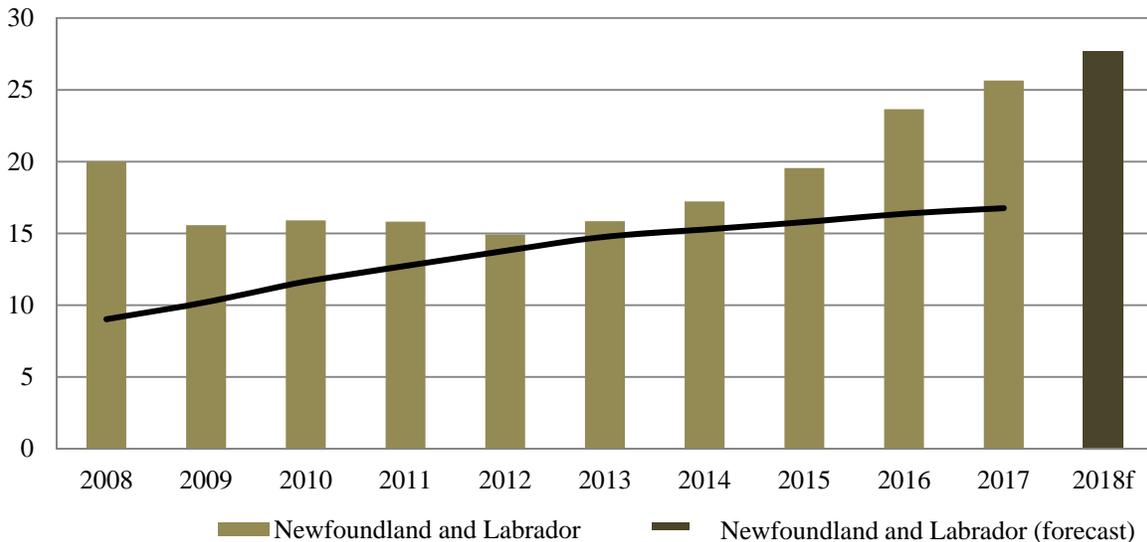
22. The Province’s Net Debt is forecast to increase to \$14.6 billion by March 31, 2018, the highest level of Net Debt in the Province’s history.
23. Net deficits, totaling \$2.1 billion, combined with spending on infrastructure from 2017-18 to 2022-23 are expected to increase Net Debt.
24. Over the period 2017-18 to 2022-23, the Province expects to borrow \$5.0 billion in the capital markets to:
 - Re-finance existing debt as it comes due.
 - Satisfy commitments under the promissory notes issued as part of the pension reform process.
 - Finance deficits and infrastructure spending.
 - Fund the Province’s currently expected share of equity for the Muskrat Falls project. Any additional cost overruns on the Muskrat Falls project would require additional equity and borrowings by the Province.

Net Debt per Capita

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

Chart 11

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



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

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

At March 31, 2017, Net Debt per capita has risen to \$25,650, the highest in the Province's history. Net Debt per capita is expected to rise to \$27,651 by March 31, 2018. Furthermore, the Province's position relative to other provinces is deteriorating and the trend is expected to continue, especially since the Province is projecting net deficits until 2022-23. Over this period, Net Debt per capita is expected to increase significantly as a result of the projected net deficits and the projected decline in the population.

Observation

25. By March 31, 2018, Net Debt per capita is expected to reach \$27,651. This level is the highest in the Province's history and would represent a significant financial burden for each and every Newfoundlander and Labradorian.

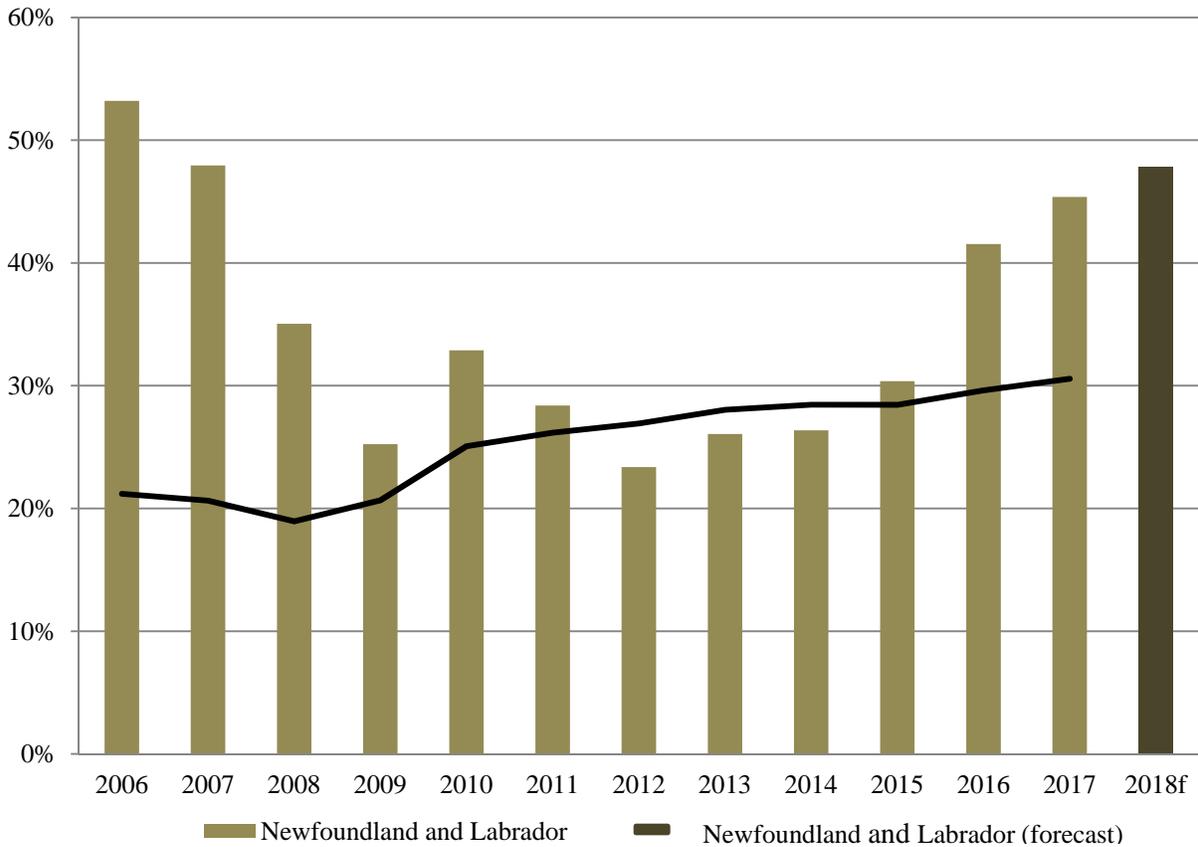
Net Debt as a percentage of GDP

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

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

Chart 12

**Province of Newfoundland and Labrador
Net Debt as a Percentage of GDP
Years Ended March 31**



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

Net Debt as a percentage of GDP had declined from 53.2% at March 31, 2006, 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, 2017, the Province’s Net Debt as a percentage of GDP has climbed to 45.4% and is now higher than the average of all other provinces. Furthermore, by March 31, 2018, the Province’s Net Debt as a percentage of GDP is forecasted to increase to 47.8%. The expectation of continued deficits beyond 2017-18 could continue to increase the ratio of Net Debt to GDP in the future.

Observation

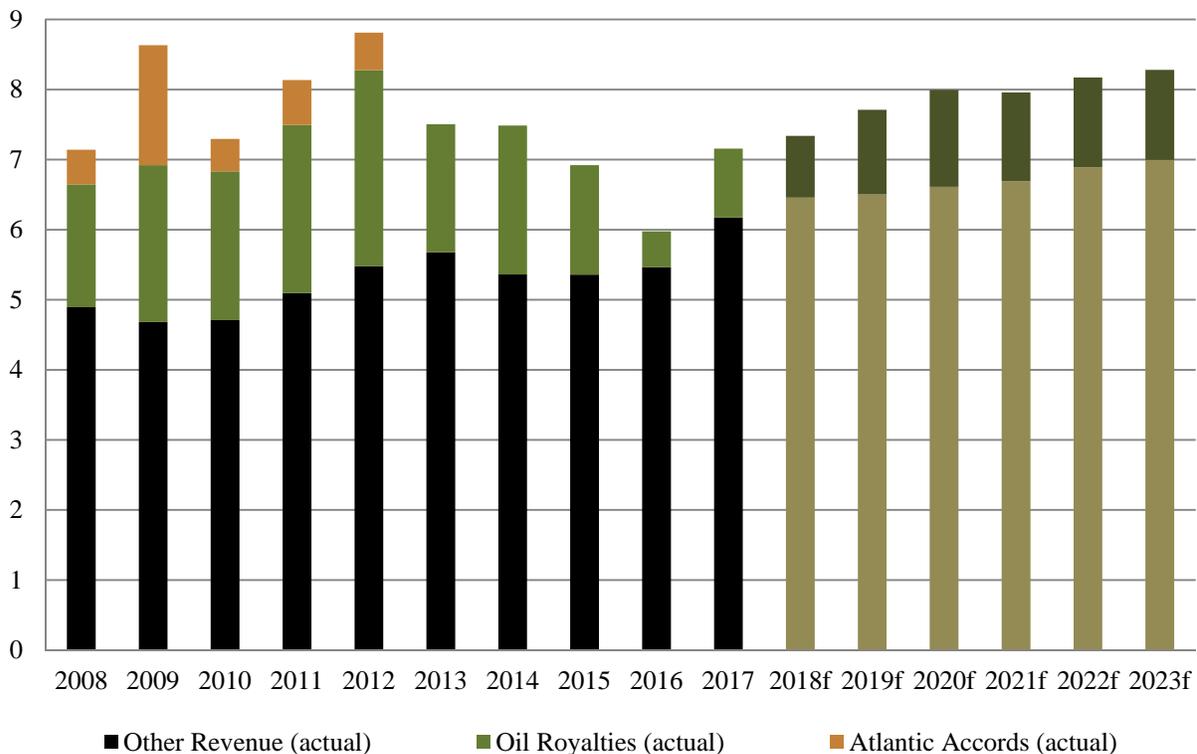
26. Net Debt as a percentage of GDP is forecast, by the Province, to increase to 47.8% at March 31, 2018. The expectation of continued deficits beyond 2017-18 could continue to increase the ratio of Net Debt to GDP in the future.

Revenues

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

Chart 13

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



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

Revenue (excluding revenue received under the Atlantic Accord arrangements) peaked in 2011-12 at \$8.3 billion. Total revenue in 2016-17 was \$7.2 billion, an increase of \$1.2 billion from the previous year but a reduction of \$1.1 billion from the peak in 2011-12.

For 2017-18, oil royalties are forecast to be \$882 million. While the significant decline in the price of oil is a contributing factor to the revenue drop that has occurred since 2011-12, declines in production are also having a negative impact. This highlights the inherent volatility associated with revenue from natural resources and, in particular, oil.

By 2022-23, the Province is forecasting that total revenue will increase an average of 2.62% a year to reach \$8.3 billion. This represents an increase of \$1.1 billion in annual revenue over the six year period.

This growth in revenue is dependent on the Province achieving the expected economic growth, the levels of oil production and oil price forecast in Budget 2017 and expected profits from Nalcor.

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

27. For the year ended March 31, 2017, total revenue was \$1.1 billion below the peak achieved in 2011-12.
28. For 2017-18, oil royalties are forecast to be \$882 million, well below the \$2.8 billion recorded in 2011-12.
29. The Province is forecasting revenue to grow by \$1.1 billion over the six year period to 2022-23. This growth in revenue is dependent on the Province achieving the economic growth and the levels of oil production and oil price forecast in Budget 2017. 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 2016-17, oil royalties dropped to \$983 million and only represented 13.7% of total revenues. In 2017-18, the Province is expecting oil royalties of \$882 million – still just 12% of total revenue.

Observations

30. Oil royalties in 2016-17 were \$983 million, a drop of \$1.8 billion from the peak of \$2.8 billion in 2011-12.
31. In 2017-18, oil royalties are expected to account for just 12% of revenue, a significant drop in six years from the peak of 33.8% in 2011-12.

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

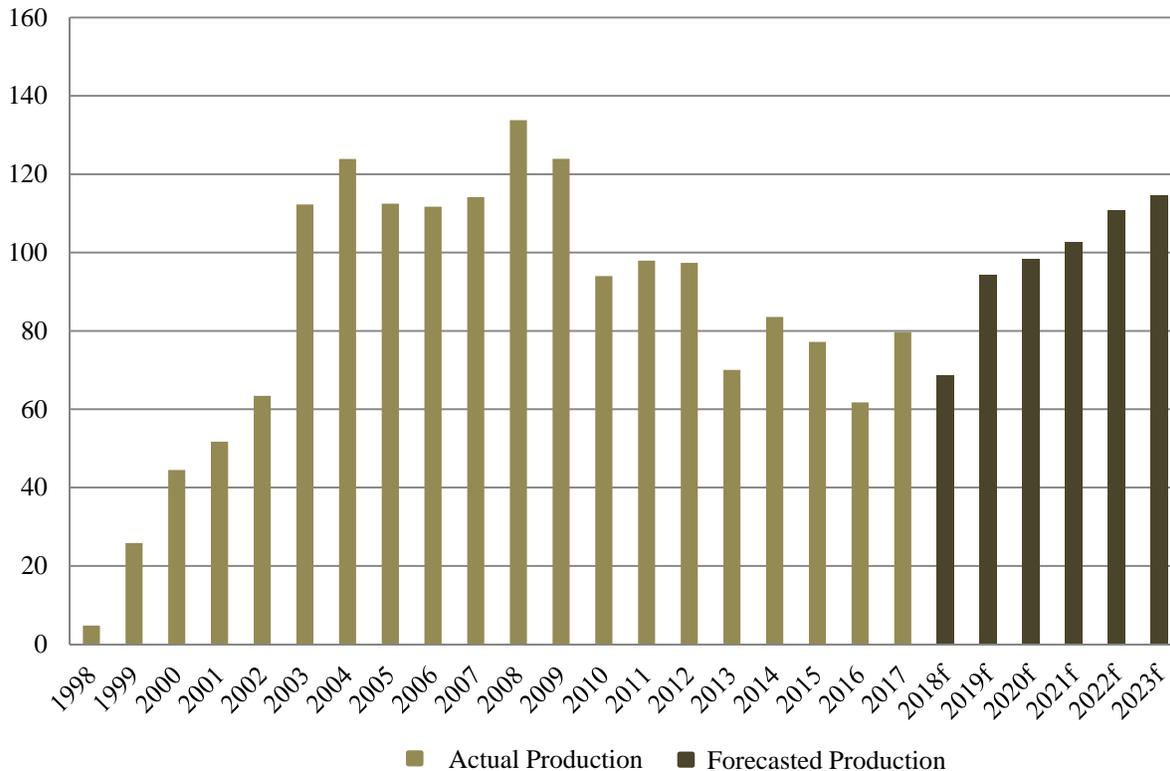
Given its lack of control over the factors that impact oil royalties, and the significant reliance on this revenue source, Government has to carefully consider the degree to which it can rely on this revenue source to fund its programs and services in the future.

Oil Production

Oil production commenced in the Newfoundland and Labrador offshore area in 1997 and peaked in 2007-08 at 133.8 million barrels. Since that time, production has been on a downward trend and totaled 79.7 million barrels in 2016-17.

Chart 14

**Province of Newfoundland and Labrador
Annual Oil Production
Years Ended March 31
(Million Barrels)**



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

Production is currently forecast by the Province to increase each year, commencing with 2018-19. The increase in production is attributed, primarily, to the commencement of production from the Hebron field, expected toward the end of 2017. By 2022-23, oil production is forecast to be 114.7 million barrels. While this represents a significant increase in production since 2016-17, it is still below the peak production of 133.8 from 2007-08.

Observation

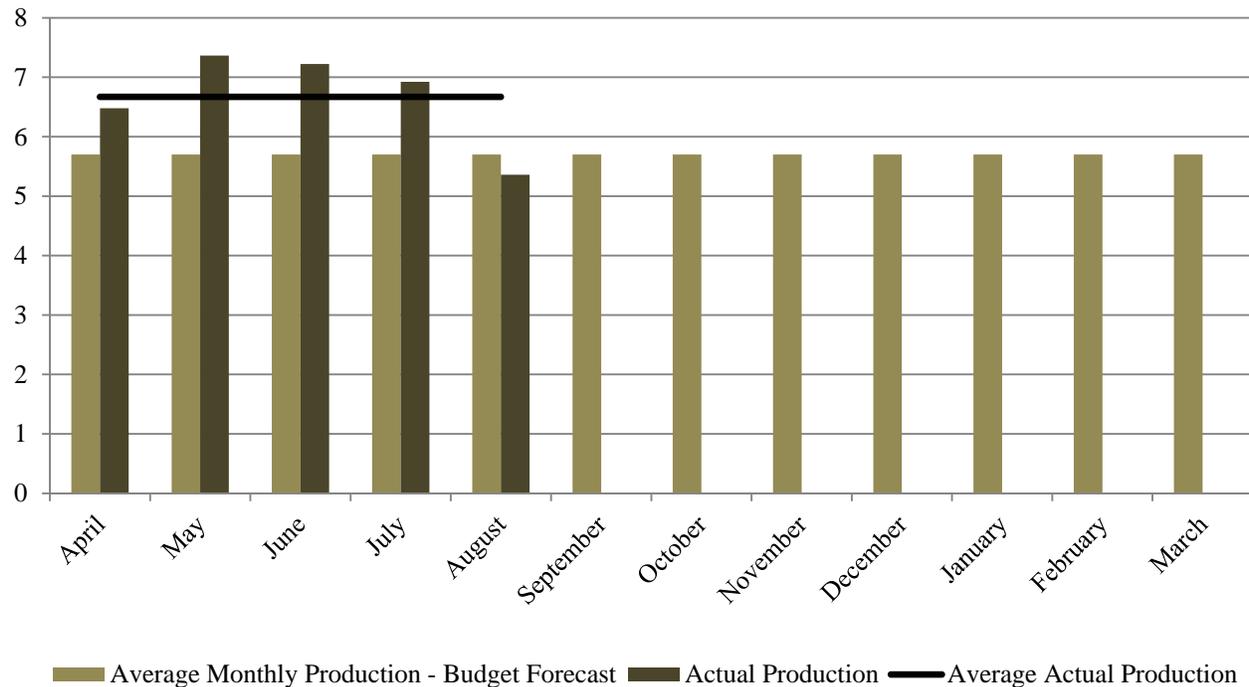
32. Annual production of offshore oil has shown a downward trend since 2007-08, but is expected to increase with the commencement of production from the Hebron field.

2017-18

Production for 2017-18 had initially been forecast to be 68.7 million barrels in Budget 2017 – an average of 5.7 million barrels per month.

Chart 15

**Province of Newfoundland and Labrador
Oil Production
Year Ended March 31, 2018
(Million Barrels)**



Source: Budget: Department of Finance

Actual: Canada-Newfoundland and Labrador Offshore Petroleum Board, September 2017

From April to August 2017, average actual monthly production has exceeded the average forecasted monthly production; however, actual monthly production has varied considerably. There is still risk that the production forecast may not be achieved.

Observation

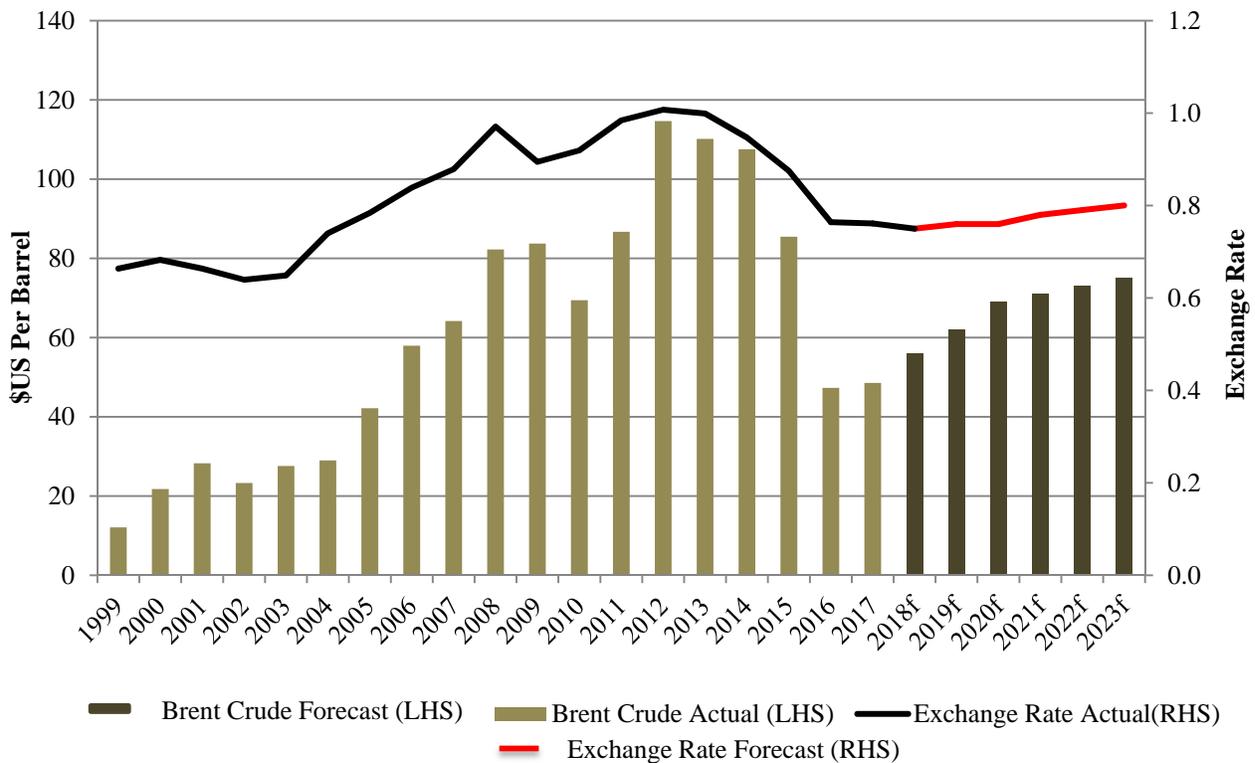
33. From April to August 2017, average actual monthly production has exceeded the average forecasted monthly production; however, actual monthly production has varied considerably. There is still risk that the production forecast may not be achieved.

Oil Price

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

Chart 16

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



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

2016-17

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 2016-17 the average price of Brent crude was \$US48.54.

Observation

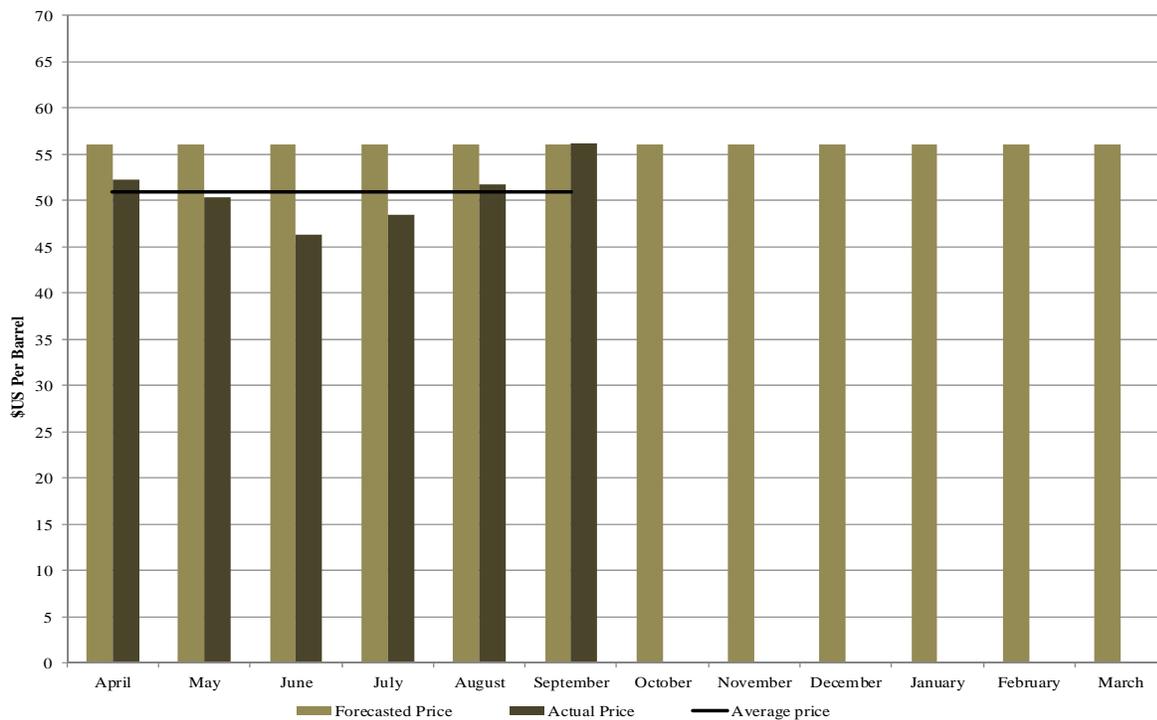
34. The average annual price of Brent Crude peaked in 2011-12 at \$US114.65 per barrel and has been steadily declining since that time. In 2016-17, the price of Brent crude averaged \$US48.54 per barrel.

2017-18

Budget 2017 had forecast the price of Brent crude to be \$US56 per barrel for 2017-18.

Chart 17

**Province of Newfoundland and Labrador
Oil Price
Year Ended March 31, 2018**



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

The price of Brent crude has averaged \$US50.89 from April to September 2017, which is less than the forecasted average price. Some risk remains around oil prices for the remainder of the fiscal year.

Observation

35. Forecasting the price of oil involves risk. During 2017-18 to date, the actual average price of Brent crude has been lower than the forecasted average price.

2018-19 to 2022-23

Of greater risk is the forecast from 2018-19 to 2022-23. The farther in the future the forecast goes, the greater the risk around predicting the oil fundamentals at that time. The Province will have to closely monitor oil prices as it manages the deficit and adjust as circumstances warrant.

The Province is forecasting the price of Brent crude to average \$US62 in 2018-19 and expects to see steady annual increases to \$US75 per barrel by 2022-23. If these price increases do not materialize, the Province will have increased pressure to achieve its surplus/deficit targets.

Observation

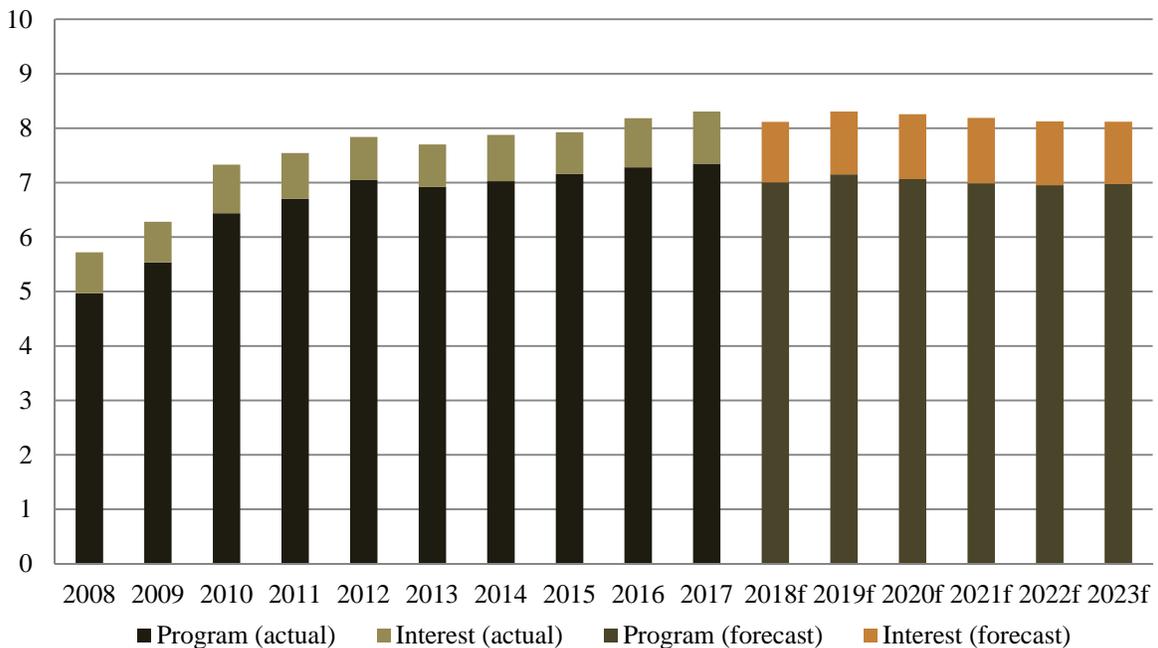
36. The Province is forecasting the price of Brent crude to average \$US62 in 2018-19 and expects to see steady annual increases to \$US75 per barrel by 2022-23. If these price increases do not materialize, the Province will have increased pressure to achieve its surplus/deficit targets.

Expenses

Total expenses have grown from \$5.7 billion in 2007-08 to \$8.3 billion in 2016-17, an increase of \$2.6 billion or 46%.

Chart 18

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



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

The current forecast to 2022-23 indicates a decline in total expenses of \$187 million or 2.3%. The decline is primarily the result of decreases in program expenses, partially offset by increases in debt servicing expenses.

Observation

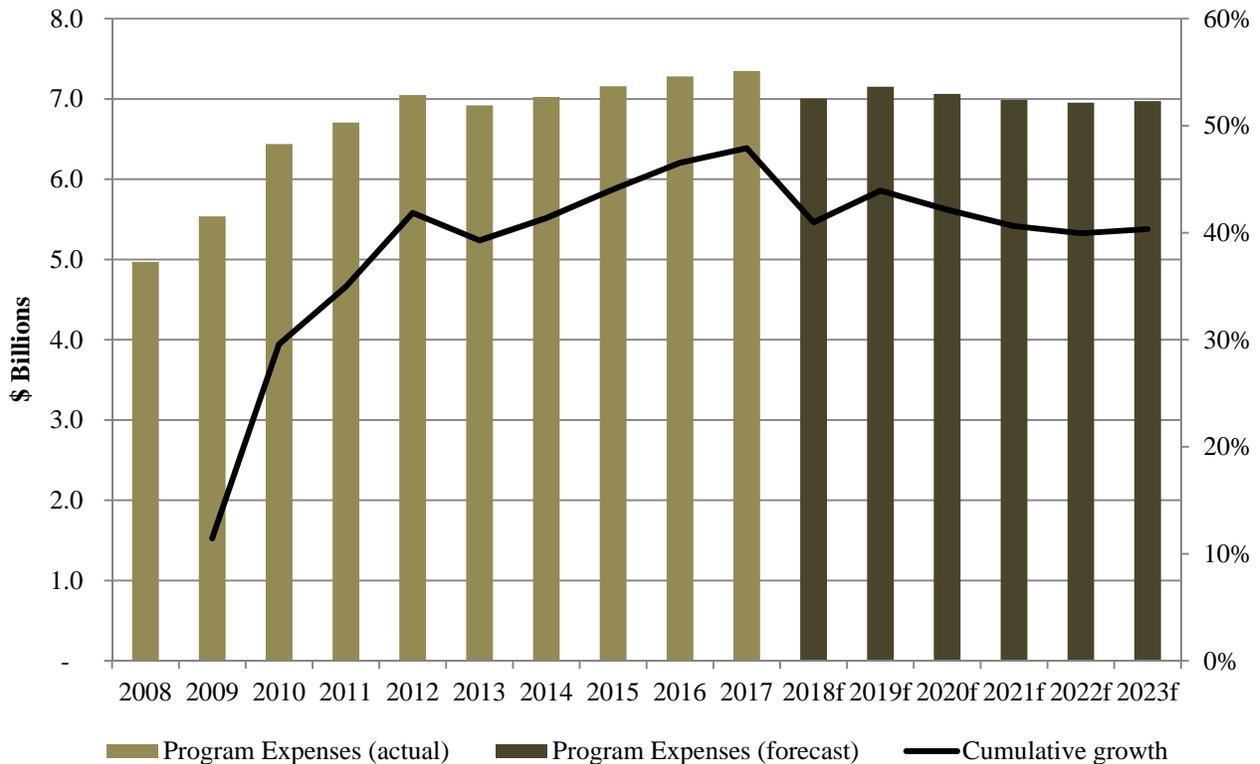
37. Total expenses have grown from \$5.7 billion in 2007-08 to \$8.3 billion in 2016-17, an increase of \$2.6 billion or 46%.

Program Expenses

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

Chart 19

**Province of Newfoundland and Labrador
Program Expenses and Cumulative Growth
Years Ended March 31**



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

2007-08 to 2016-17

Since 2007-08, program expenses have grown by \$2.4 billion to \$7.3 billion in 2016-17. This represents cumulative growth over that period of 47.9%. The largest portion of this growth occurred between the period 2007-08 and 2009-10, a period when the Province was experiencing strong revenue growth.

While growth in program expenses slowed between 2011-12 and 2016-17, an additional \$301 million was added to program expenses over that period.

Observation

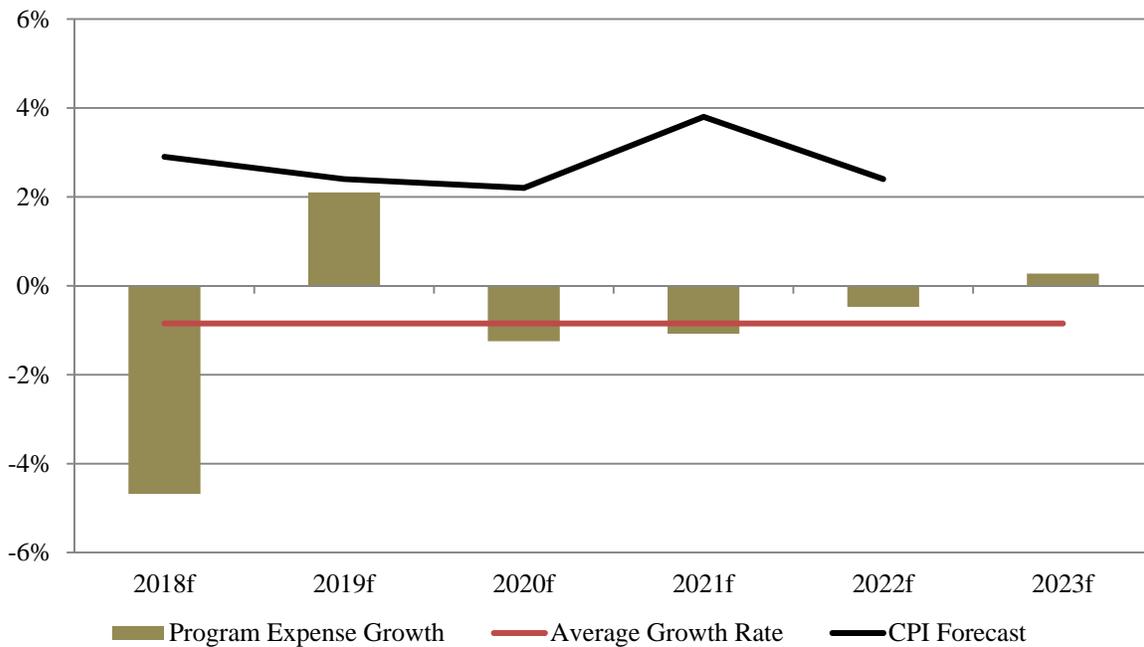
38. Program expenses have grown by 47.9% over the period from 2007-08 to 2016-17.

2017-18 to 2022-23

The Province included its forecast of expenses from 2017-18 to 2022-23 in Budget 2017.

Chart 20

**Province of Newfoundland and Labrador
Forecast Program Expense Growth
Years Ended March 31**



Source: Department of Finance

The forecast expects an average decline in program expenses of 0.85% from 2017-18 to 2022-23, which is less than the Province’s expected CPI growth over the same period. Therefore, the decline in program expenses of \$376 million would not allow for inflationary or other pressures.

Observation

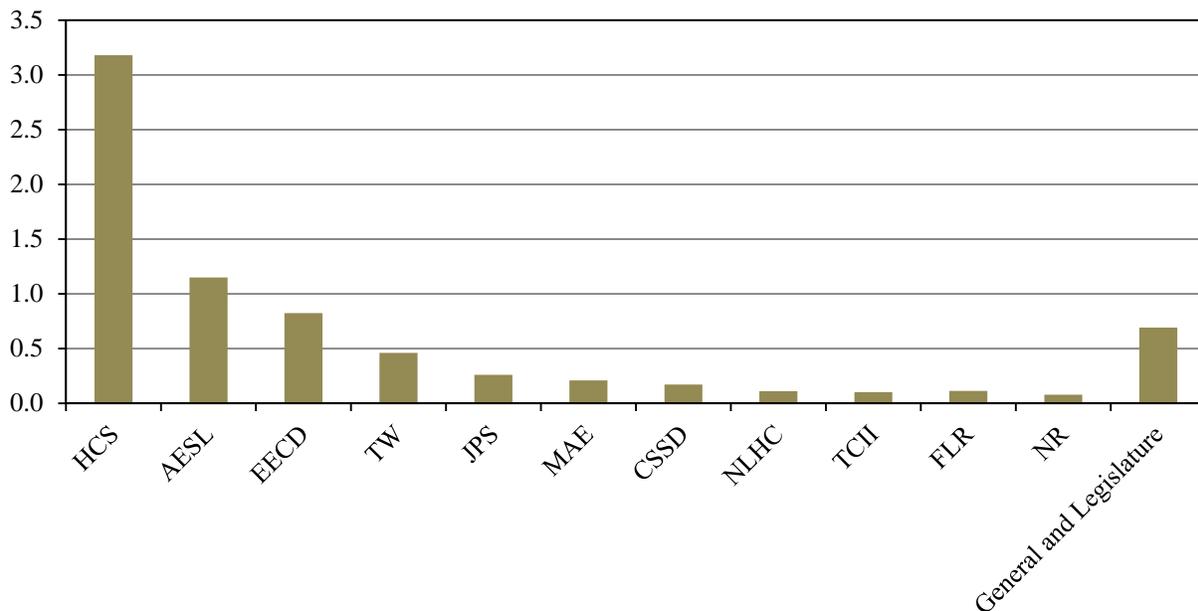
39. Program expenses are forecast to decline by approximately \$376 million between 2017-18 and 2022-23 - an average decline of 0.85%. This decline in program expenses is less than the expected rate of inflation and would not allow for inflationary or other pressures.

Program Expenses by Department

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

Chart 21

**Consolidated Summary Financial Statements
Program Expenses by Department
Year Ended March 31, 2017
(\$ Billions)**



\$3.2 billion of the \$7.1 billion of program expenses incurred in 2016-17 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, 43% is spent on health care.

The Departments of Advanced Education, Skills and Labour, and Education and Early Childhood Development, combined, account for \$2.0 billion in program expenses, or almost 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.

Observation

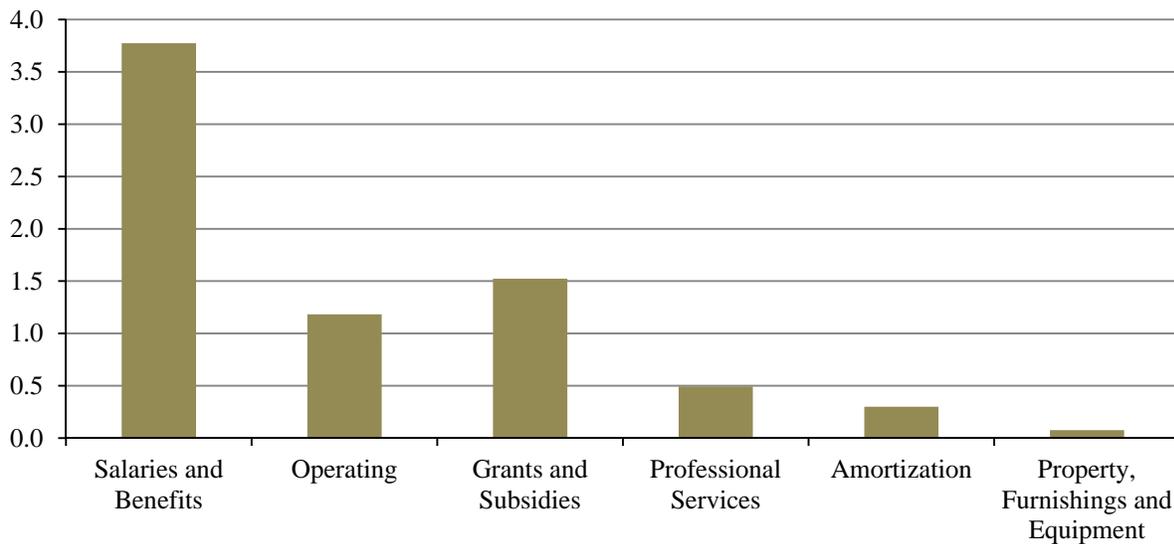
40. Almost 70% of program expenses are directed to the health, education and skills development sectors.

Program Expenses by Category

Government provides services to residents throughout the Province.

Chart 22

Consolidated Summary Financial Statements Program Expenses by Category Year Ended March 31, 2017 (\$ Billions)



As with any organization providing a service or services, the Province spends the majority of its expenses on human resources – its employees. In 2016-17, the Province spent \$3.8 billion on salaries and employee benefits - 51% of the total program spending of Government.

Not only is 70% of spending directed to health, education and skills development, but, 51% of costs are related to people.

Observation

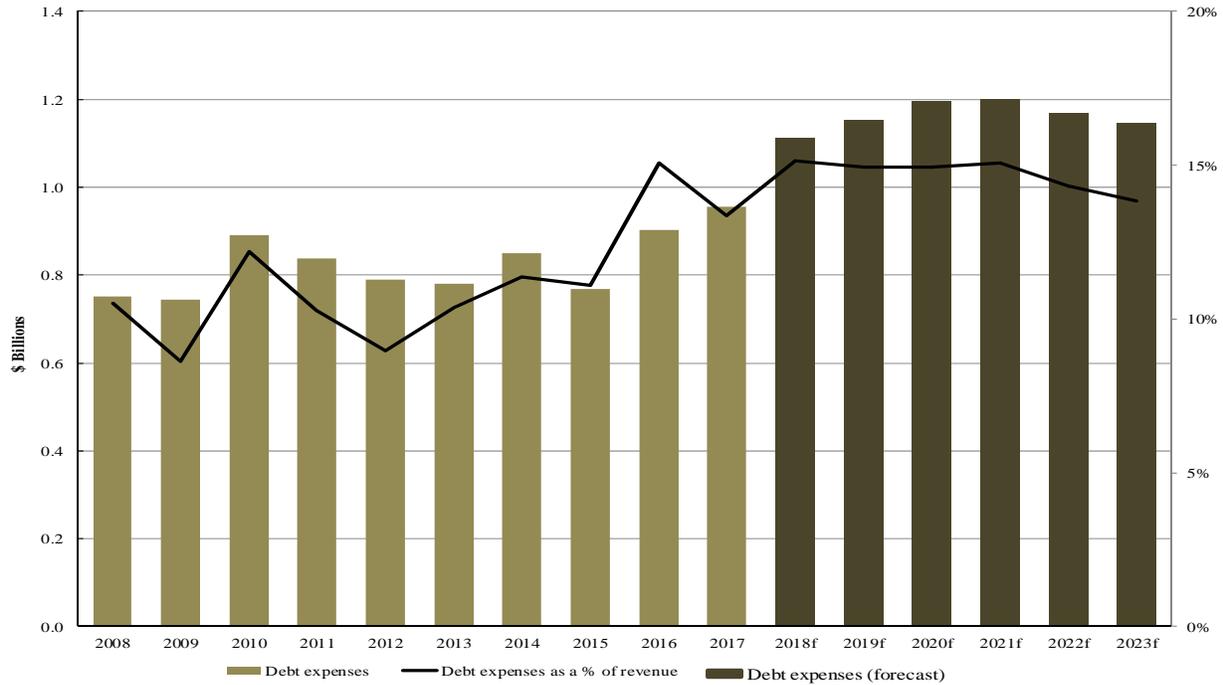
41. In 2016-17, the Province spent \$3.8 billion on salaries and employee benefits - 51% of the total program spending of Government.

Debt expenses

Money allocated to servicing debt is money that is not available to fund programs and services. Government incurs interest costs on its borrowings, as well as on its liabilities related to employee post-retirement benefits. At March 31, 2017, Government borrowings, net of sinking funds, were \$10.6 billion, its unfunded pension liability was \$4.9 billion and its unfunded group health and life insurance retirement benefits liability was \$2.9 billion.

Chart 23

**Province of Newfoundland and Labrador
Debt expenses and as a Percentage of Revenue
Years Ended March 31**



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

Debt expenses as a percentage of revenue, sometimes called the “interest bite”, is an important indicator of the state of government finances. It indicates how much of a province’s revenues first must go to pay for past borrowings before being able to fund current Government programs. Debt expenses as a percentage of revenue has increased overall since 2008 and is at 13.4% for 2016-17 and expected to average 14.7% between 2017-18 and 2022-23.

From 2007-08 to 2016-17 debt expense averaged \$827 million. In Budget 2017, the Province forecast debt servicing expenses to be \$1.11 billion for 2017-18 and then average \$1.17 billion between 2018-19 and 2022-23.

Observations

- 42. Money allocated to servicing debt is money that is not available to fund programs and services.
- 43. Between 2017-18 and 2022-23, the Province expects, on average, to allocate 14.7% of every dollar of revenue generated to debt expense.

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, 2017. 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, 2017

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 911 Bureau Inc.
	Newfoundland and Labrador Centre for Health Information
	Newfoundland and Labrador English School District
	Newfoundland and Labrador Film Development Corporation
	Newfoundland and Labrador Liquor Corporation
	Newfoundland and Labrador Sports Centre Inc.
	Newfoundland Hardwoods Limited
	Newfoundland Ocean Enterprises Limited
	Western Regional Health Authority
Unaudited	
Churchill Falls (Labrador) Corporation Trust	
No Financial Statements Prepared	
Newfoundland and Labrador Farm Products Corporation	

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

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

For the year ended March 31, 2017, 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, revenues 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, 2017), 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, 2017) 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, 2017, 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.

Issues Identified During our Audit of the Consolidated Summary Financial Statements

Each year during our audit of the Province's Consolidated Summary Financial Statements (Public Accounts), we observe opportunities to improve internal controls, financial statement preparation or financial reporting. These observations do not affect our audit opinion on the fairness of the Public Accounts.

During the audit of the Public Accounts for the year ended March 31, 2017, we identified several issues. We have made recommendations to Government to address these issues and we encourage Government to implement them.

We communicated the following significant issues to Government:

Control environment and internal controls

Internal controls help to minimize operational, fraud, and financial reporting risks. Therefore, it is important to address issues that are identified to ensure internal controls are operating effectively.

The Professional Services and Internal Audit division of the Department of Finance has been completing fraud risk assessments at government departments since 2014-15. These assessments have identified areas where there are greater risks of fraud occurring. Government should continue assessments of fraud risk and where appropriate implement controls to minimize fraud risk.

Also, we noted issues with the controls over access to the Government's financial management system during our testing of these controls. In addition, we noted several issues with internal controls over receipting in the Central Cashier's Office during our testing of internal controls.

Compliance with Public Sector Accounting Standards

Compliance with Public Sector Accounting Standards helps to provide users of the Public Accounts with financial information that is comparable with other jurisdictions in Canada.

Government does not record actuarially determined liabilities and expenses for severance or accumulating non-vesting sick leave benefits for employees in core Government, a requirement of Public Sector Accounting Standards. The liability and expense for severance is determined by using management's best estimate based on the vested portion only. In addition, Government uses management's best estimate of the probability of the employees utilizing sick leave benefits to determine the liability and expense for these benefits.

Estimation of taxation revenues

The Province often has significant amounts owing from or to the Government of Canada related to underpayments or overpayments under the Tax Collection Agreement. These underpayments or overpayments are included with or recovered from future entitlements under the Agreement.

The Government of Canada, with input from the Province and in accordance with the Agreement, provides revenue estimates to the Province for Corporate Income Tax, Personal Income Tax, and Harmonized Sales Tax. These estimates are revised in subsequent periods as information that is more accurate becomes available. The resulting adjustments are recorded as they become known in future periods.

The development of a more accurate estimation methodology for these revenues may provide more reliable and accurate results.

Completeness of the Government Reporting Entity

Ensuring the completeness of the Government Reporting Entity will provide users of the Public Accounts with the most comprehensive accounting of the Province's financial position and the results of its operations. The Office of the Comptroller General is responsible for assessing whether entities should be included or excluded from the Government Reporting Entity. If an assessment determines that Government controls an entity, it will be included in the Government Reporting Entity.

In previous audits, we have identified entities that should be considered for inclusion in the Government Reporting Entity and have requested the Office of the Comptroller General to complete assessments to determine whether control exists. Also, certain entities which are presently included in the Government Reporting Entity are questioning whether they are controlled, either directly or indirectly, by Government.

The Office of the Comptroller General has commenced a comprehensive review of entities previously included or excluded from the Government Reporting Entity to determine whether control exists. We encourage the Office of the Comptroller General to continue with this review.

Preparation of the Public Accounts

It is important to use complete and accurate information to prepare the Public Accounts to reduce the risk of error and improve the timeliness of completing the Public Accounts. We noted instances where the Office of the Comptroller General received incomplete or inaccurate information from departments and Crown corporations for use in preparing the Public Accounts.

The comparison of actual and budgeted financial results provides key accountability information about the government's performance in achieving its operational goals. We noted instances where budget information that was included in the Public Accounts was prepared on a basis that was inconsistent with the presentation and classification in the Public Accounts. As a result, it may be difficult to compare actual results to planned results.

Issues identified During Audits of the Financial Statements of Crown entities

The Public Accounts include the financial activities of the Consolidated Revenue Fund (core Government) as well as 43 other Crown entities. In addition to the audit of the Consolidated Revenue Fund, our Office audits the financial statements of 16 of these 43 other Crown entities. We also audit the financial statements of the Province of Newfoundland and Labrador Pooled Pension Fund and the Newfoundland and Labrador Government Sinking Fund.

Each year during our audits of the financial statements of Crown entities, we observe opportunities to improve internal controls, financial statement preparation or financial reporting. These observations generally do not affect our audit opinion on the entity's financial statements, but we will communicate the observations to each entity in writing.

During the audits of certain Crown entities for the current year we identified several issues, which we communicated to the entities. We have made recommendations to each entity to address these issues and we encourage the entities to implement them.

Private sector auditors perform audits of the financial statements for 25 of the 43 other Crown entities that are included in the Public Accounts. Section 14 of the *Auditor General Act* requires private sector auditors to provide our Office with access to all working papers, reports, schedules and other documents related to their audit of a Crown entity. Also, as the group auditor of the Public Accounts, we request certain information from private sector auditors and will review their audit documentation if a Crown entity is considered significant.

We reviewed management letters and other communications that the private sector auditors issued to these entities to identify issues which may be interest to the House of Assembly. We encourage the entities to implement the recommendations that their auditors made to address the issues identified.

The following is a summary of the issues communicated to the entities during the current year from our Office and from private sector auditors.

Table 2

**Number of issues identified by entity
March 31, 2017**

Number of issues	Number of entities audited by the Office of the Auditor General	Number of entities audited by private sector auditors
No issues	8	12
1 to 4 issues	7	10
5 or more issues	3	1
Auditor communication not finalized	-	2
Total	18	25

We have summarized the issues noted by the following categories: internal controls, maintenance of accounting records, financial statement preparation, and other.

Table 3

**Types of issues identified
March 31, 2017**

Issue	Number of entities audited by the Office of the Auditor General where the issue was identified	Number of entities audited by private sector auditors where the issue was identified
Internal controls	7	7
Maintenance of accounting records	6	4
Financial statement preparation	4	1
Other	2	5

Internal controls

Issues that our Office identified related to internal controls included:

- improper segregation of duties,
- deficiencies related to revenue receipting,
- absence of a formal risk assessment process, and
- other deficiencies related to the control environment.

Issues that private sector auditors identified related to internal controls included:

- improper segregation of duties,
- deficiencies with system access controls,
- absence of an internal audit function or vacancies within the internal audit function, and
- deficiencies related to controls over purchasing.

Internal controls help to minimize operational, fraud, and financial reporting risks. Therefore, it is important to address issues that are identified with internal controls. In particular, proper segregation of duties is important to prevent loss or misappropriation of assets or occurrences of fraud or error.

Maintenance of accounting records

Issues that our Office identified related to the maintenance of accounting records included:

- accounts not being reconciled on a timely basis,
- unsupported account balances,
- entity not being ready for audit, and
- general poor quality of the entity's accounting records.

Issues that private sector auditors identified related to the maintenance of accounting records included:

- deficiencies with processes for preparing accruals for severance and vacation,
- Harmonized Sales Tax reporting period not corresponding to the fiscal year, and
- the need for an entity to use a system to account for its tangible capital assets.

It is necessary for entities to maintain their accounting records accurately and in a timely manner to promptly identify and address transactions that are potentially incorrect or inappropriate. It is important for entities to be ready for audit on time in order to meet the deadlines established by legislation and to provide timely financial information to the users of their financial statements.

Financial statement preparation

Issues that our Office identified related to financial statement preparation included:

- inappropriate application of accounting policies, or
- absence of accounting policies.

A private sector auditor identified that an entity needed to develop accounting policies related to tangible capital assets.

Accounting policies should be developed and applied appropriately to ensure consistent accounting for transactions at the entity and to provide users of the entity's financial statements with financial information that is comparable with other entities in the Public Sector.

Other

Other issues identified by our Office included non-compliance with:

- direction from the Lieutenant-Governor in Council,
- Government purchasing guidelines, and
- collective agreements.

Other issues identified by private sector auditors included:

- allegations of fraud by certain employees,
- the need for a succession plan,
- holding surplus funds in a non-interest bearing account, and
- non-compliance with the *Public Tender Act*.

Our Office, at the request of the Lieutenant-Governor in Council, is currently investigating allegations of fraud at the Crown entity referenced in the management letter issued by the private sector auditor.

Crown entities should comply with legislation, direction from Government, and collective agreements.

When an entity has a significant number of employees eligible for retirement, it is important to have a succession plan to help ensure that the entity's operations continue to run smoothly.

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, 2017. 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, 2017). 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, 2017.

Table 1

Consolidated Summary Financial Statements
Components of the Consolidated Statement of Financial Position
As at March 31, 2017
(\$000s)

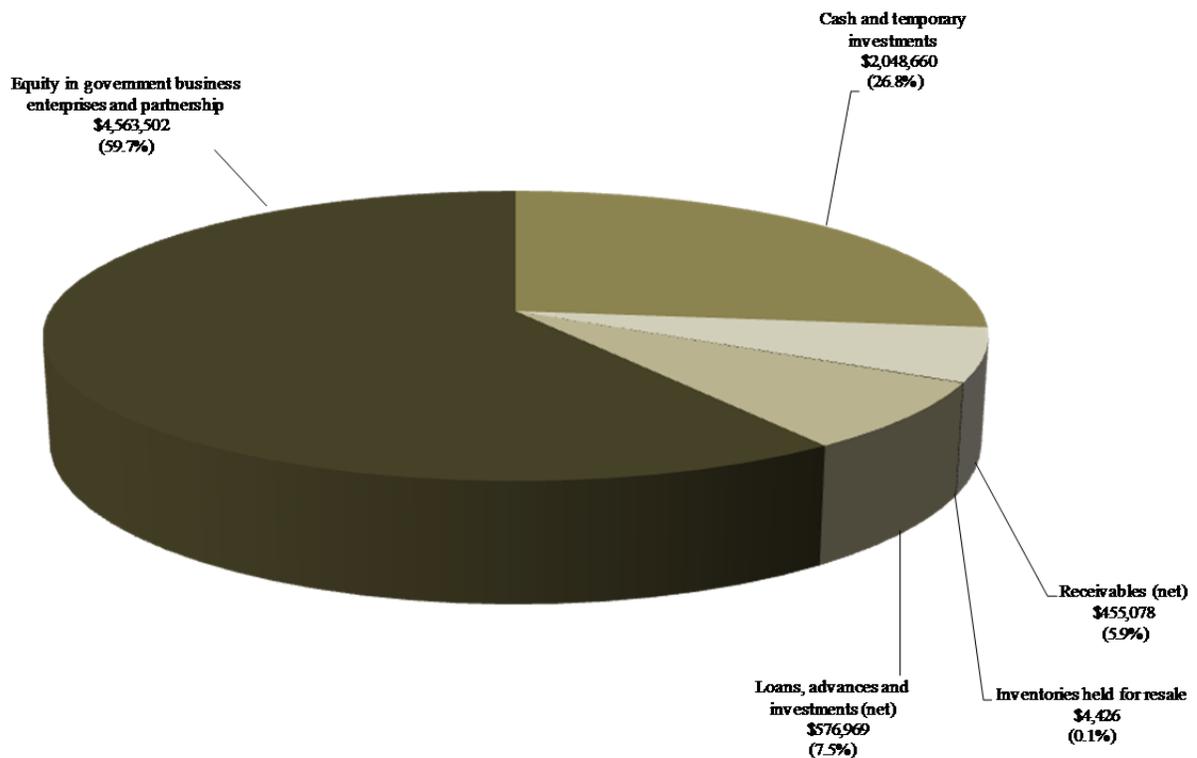
Component	Amount
Financial Assets	\$ 7,648,635
Liabilities	21,246,441
Net Debt	13,597,806
Non-financial Assets	4,405,957
Accumulated Deficit	\$ 9,191,849

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, 2017.

Chart 1

**Consolidated Summary Financial Statements
Financial Assets
As at March 31, 2017
(\$000s)**



Total: \$7,648,635

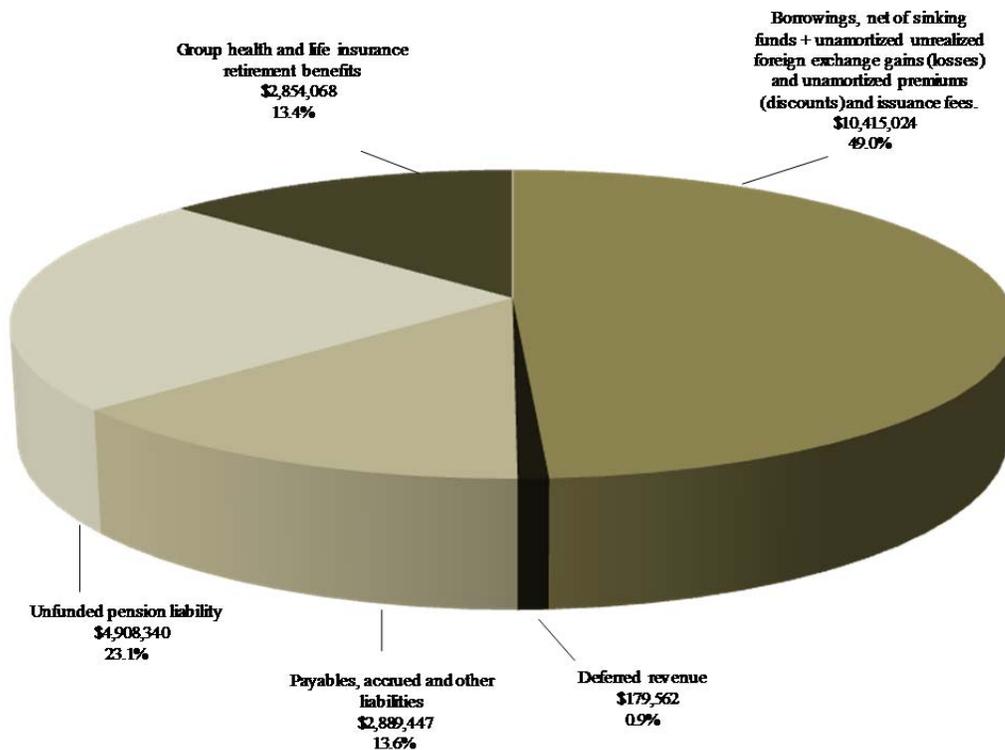
Equity in Government Business Enterprises and partnership reflects the net assets (assets less liabilities) of Nalcor Energy, the Newfoundland and Labrador Liquor Corporation, and Government's 25% equity interest in the Atlantic Lottery Corporation, Inc. This equity is used by these entities to generate 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, 2017.

Chart 2

**Consolidated Summary Financial Statements
Liabilities
As at March 31, 2017
(\$000s)**



Total: \$21,246,441

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, 2017, was \$13.6 billion (2016 - \$12.5 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, 2017, were:

• Tangible capital assets	\$4.31 billion
• Prepaid expenses, deferred charges and inventories	<u>0.10 billion</u>
Total Non-financial Assets	<u>\$4.41 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, 2017, was \$9.2 billion (2016 - \$8.1 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.

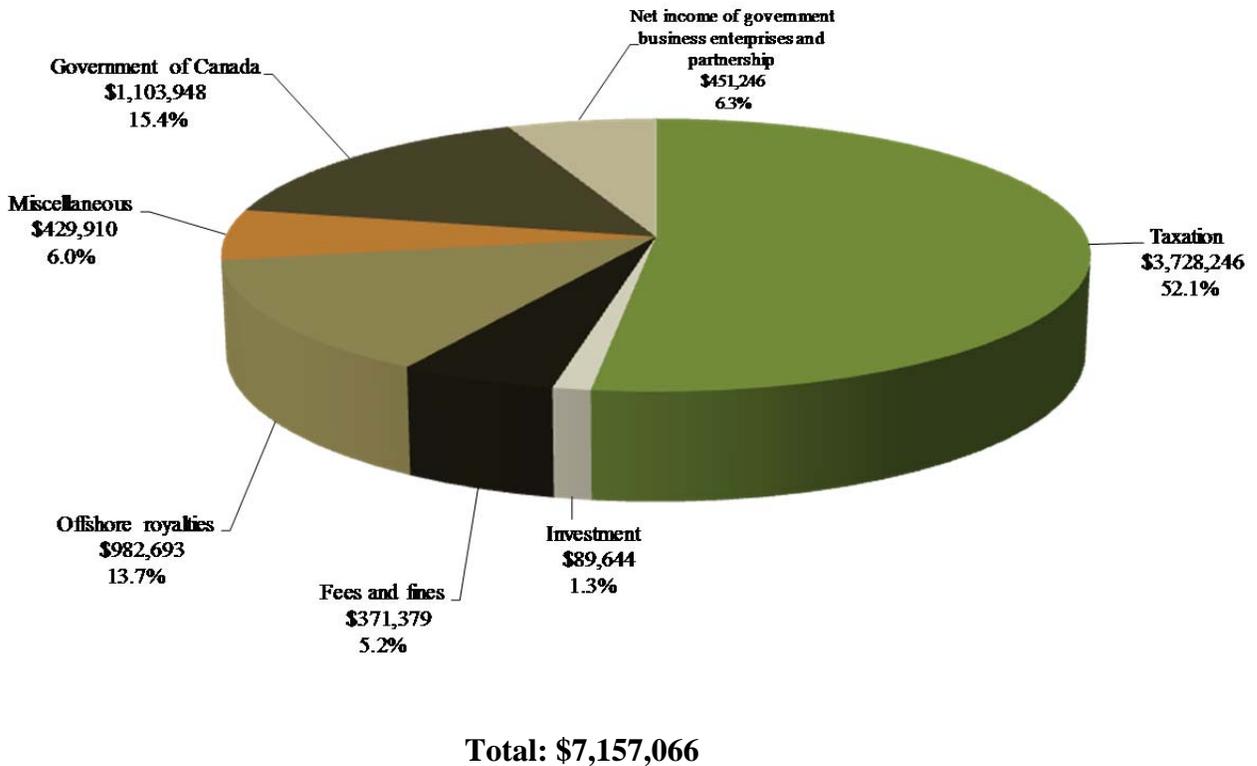
Consolidated Statement of Operations

This statement shows the results of the operations of the Government Reporting Entity for the year April 1, 2016 to March 31, 2017, 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, 2017. Approximately 13.7% of the Province’s total revenues came from offshore royalties.

Chart 3

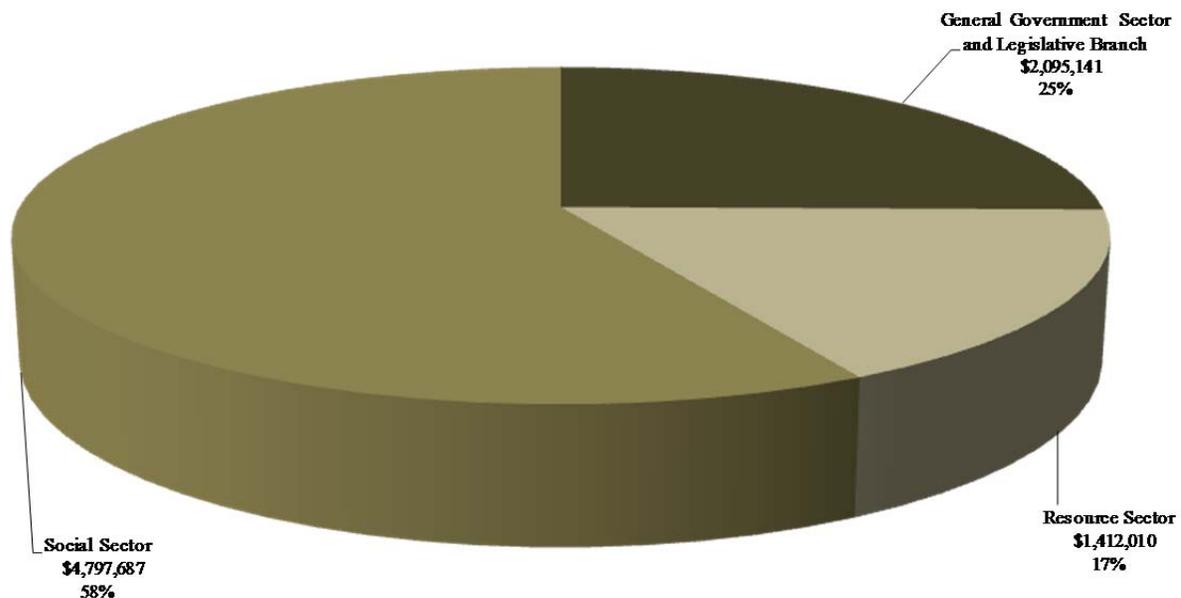
**Consolidated Summary Financial Statements
Revenues by Source
Year Ended March 31, 2017
(\$000s)**



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, 2017. Approximately 58% of the Province's total expenses of \$8.3 billion were spent in the social sector.

Chart 4

Consolidated Revenue Fund Financial Statements
Expenses by major functional area
Year Ended March 31, 2017
(\$000s)



Total: \$8,304,838

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 \$1.1 billion for the year ended March 31, 2017 (2016 - \$2.2 billion deficit).

Consolidated Statement of Changes in Accumulated Deficit

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

The accumulated deficit at the end of the fiscal year is also impacted by adjustments to the opening balance of accumulated deficit. For the year ended March 31, 2017, 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.

Consolidated Statement of Cash Flows

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

- Operations
- Capital Transactions
- Financing Activities
- Investing Activities

Notes to the Consolidated Financial Statements and Schedules

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

APPENDIX

I

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

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

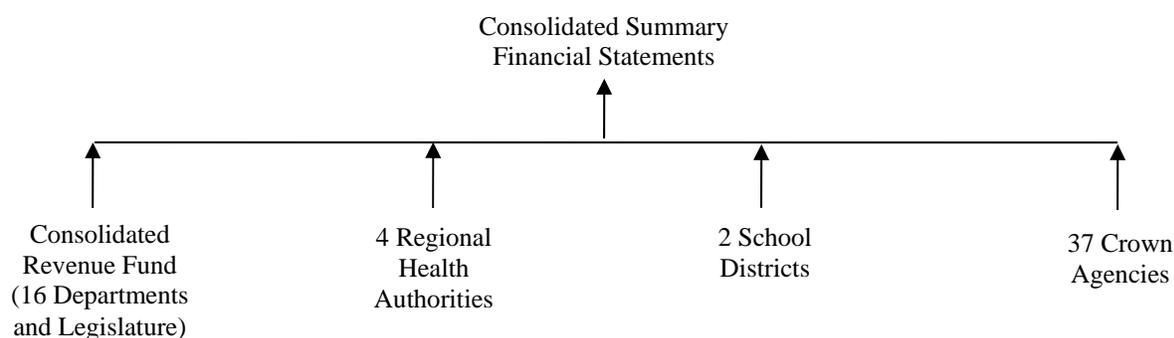
The Public Accounts of the Province of Newfoundland and Labrador for the year ended March 31, 2017, consists of the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador. The Consolidated Summary Financial Statements are prepared on the accrual basis of accounting in 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 16 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, 2017



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

What Statements are included and what do they show?

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

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

Consolidated Statement of Financial Position

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

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

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

Consolidated Statement of Change in Net Debt

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

Consolidated Statement of Operations

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

Consolidated Statement of Change in Accumulated Deficit

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

Consolidated Statement of Cash Flows

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

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

What accounting policies does Government follow?

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

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

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

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

- the recording of revenues related to sales taxes, income taxes, and various transfers from the Government of Canada;
- the accrual of environmental remediation obligations; and
- the accrual of retirement benefits (*e.g.*; Pensions, Group Health and Life Insurance).

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

Who audits the Public Accounts?

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

Why are they audited?

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

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

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

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

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

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

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

**APPENDIX
II
GLOSSARY**

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 Government 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 and compensated absences.
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, unless otherwise indicated, 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.
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.

