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, 2019

OFFICE OF THE AUDITOR GENERAL
NEWFOUNDLAND AND LABRADOR

Office of the Auditor General
Newfoundland and Labrador

The Office of Auditor General is committed to promoting accountability and encouraging positive change in the stewardship, management and use of public resources. The Auditor General reports to the House of Assembly on significant matters which result from the examinations of Government, its departments and agencies of the Crown. The Auditor General is also the independent auditor of the Province's financial statements and the financial statements of many agencies of the Crown and, as such, expresses an opinion as to the fair presentation of their financial statements.

VISION

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

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OFFICE OF THE AUDITOR GENERAL
NEWFOUNDLAND AND LABRADOR

December 2019

Honourable Scott Reid, 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, 2019.

Respectfully submitted,

Julia Mullaley

JULIA MULLALEY, CPA, CA
Auditor General

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CHAPTER 1

INTRODUCTION

Introduction

The Consolidated Summary Financial Statements (commonly referred to as the Public Accounts) reflect the financial position and annual operating results of all organizations in the Government Reporting Entity. This includes Government departments and the Legislature and all other Government entities that are controlled by Government and are accountable to either a Minister of a Government Department or directly to the Legislature for the administration of their financial affairs and resources. A full listing of the Government Reporting Entity is included in Appendix I.

The Consolidated Summary Financial Statements provide the most complete information about the financial position and operating results of the Province. They are an important document which serve as the principal means by which Government reports to the House of Assembly and to all Newfoundlanders and Labradorians on its accountability and stewardship of public funds.

This Report provides information on the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador for the year ended March 31, 2019. This information is intended to provide an overview of the financial condition of the Province and changes in its financial position and operations from the previous year. It also includes observations on other matters that came to my attention during our audit of the Province's financial statements.

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 staff of the Office of the Auditor General for their hard work, professionalism and dedication.

Julia Mullaley

JULIA MULLALEY, CPA, CA
Auditor General

CHAPTER 2

INDEPENDENT AUDITOR'S REPORT

Responsibility for the Consolidated Summary Financial Statements

Government, through the Office of the Comptroller General, is responsible for providing the House of Assembly with the Province's Consolidated Summary Financial Statements. These statements are 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. This Statement outlines Government's responsibility 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 financial statements are prepared 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.

The Auditing and Assurance Standards Board issued a revised standard for forming an opinion and reporting on financial statements which was effective for the performance of audits of financial statements for periods ending on or after December 15, 2018. As a result of this revised standard, the form and content of the Independent Auditor's Report was revised. The primary revisions included expanded descriptions of the responsibilities of management, those charged with governance, and the auditor. Our audit opinion on the Consolidated Summary Financial Statements for the year ended March 31, 2019 was prepared using the revised format.

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

Audit Opinion

An unqualified audit opinion was issued on the Consolidated Summary Financial Statements for the year ended March 31, 2019, concluding that they were fairly presented, in all material respects, in accordance with Canadian Public Sector Accounting Standards.

This audit opinion does not extend to the effectiveness of internal controls as this is not the focus of a financial statement audit. Consistent with GAAS, however, if we identify matters during our audit which result in recommendations to improve controls or management practices, we communicate these matters in writing to Government. Recommendations communicated to Government as a result of our audit of the Consolidated Summary Financial Statements for the year ended March 31, 2019 are outlined in Chapter 5 - Other Matters.

Other Information

Government includes a Financial Statement Discussion and Analysis report with the Consolidated Summary Financial Statements to provide an overview of changes in Government's financial position and to highlight key figures and comparatives. This report is considered part of the "other information" that is included in the Public Accounts of the Province. Our opinion on the Consolidated Summary Financial Statements does not cover the other information and we do not express any form of assurance conclusion thereon. However, GAAS requires us to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or knowledge we obtained during the audit, or otherwise appears to be materially misstated. If we conclude that there is a material misstatement of this other information, we are required to report that fact. For the year ended March 31, 2019, we had nothing to report in this regard.

Other Matter

GAAS allows an auditor to include additional communication in the Independent Auditor's Report if an auditor considers it necessary to do so. One such communication is an "Other Matter" paragraph. An Other Matter paragraph is a paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

In April 2019, Government released a proposed framework reconfirming its commitment that electricity rates would not be impacted as a result of the Muskrat Falls project and outlined possible options to mitigate the increases in electricity rates. Government has requested the Board of Commissioners of Public Utilities (PUB) to examine options to mitigate impacts of the Muskrat Falls project with a final report to be provided to Government by January 31, 2020. Government is not expected to finalize its rate mitigation plan until after it receives the final report from the PUB.

In its Financial Statement Discussion and Analysis report for the year ended March 31, 2019, Government included commentary on risks to the Province's financial position and forecast which included risks relating to Government's rate mitigation strategy for the Muskrat Falls project. However, the Consolidated Summary Financial Statements for the year ended March 31, 2019 do not disclose information regarding Government's rate mitigation plan as such disclosure for this reporting timeframe was not required by Canadian Public Sector Accounting Standards.

We, nonetheless, felt it was important to include an Other Matter paragraph in our Independent Auditor's Report on the Consolidated Summary Financial Statements for the year ended March 31, 2019. This Other Matter paragraph highlighted that, while Government has not yet finalized specific strategies for its rate mitigation plan, implementation of this plan may have a significant impact on the Province's Consolidated Summary Financial Statements in future years. We further noted that we did not modify our audit opinion because of this matter. This is consistent with GAAS.

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. 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, 2019), 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, 2019) 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.

CHAPTER 3

THE FINANCIAL CONDITION OF THE PROVINCE

Province's Consolidated Financial Results - 2019

This chapter reports on the financial condition of the Province by expanding on the information contained in the Consolidated Summary Financial Statements. It provides an overview of the Province's financial position at March 31, 2019 with comparative information for the 10-year period ending March 31, 2019. It also considers forecasted financial information for 2019-20 to 2022-23 obtained from Budget 2019, the December 2019 Fiscal and Economic Update and other publicly available information.

The Province's 2019 Fiscal and Economic Update released on December 11, 2019, provided an update on the expected financial results for 2019-20 but did not provide any further update to the forecast from 2020-21 to 2022-23. The most recent medium-term projections discussed in this Chapter are outlined in Budget 2019. These medium-term projections are expected to be updated in Budget 2020.

Various indicators can be used to assess the Province's financial condition. The indicators discussed in this chapter are among those recommended for reporting by the Public Sector Accounting Board. These indicators combined assess the financial condition of a government: its financial health as measured by sustainability, flexibility and vulnerability, looked at in the context of the Province's overall economic and financial environment.

Sustainability - whether a government is living within its means

Flexibility - whether a government can meet rising commitments by expanding its revenues or increasing its debt

Vulnerability - the extent to which a government relies on sources of funding outside its control to pay for existing programs and services

Sustainability

Sustainability is the degree to which a government can maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy. Sustainability indicators included in this chapter include Government's:

- annual surplus or deficit;
- surplus/deficit as a percentage of province's gross domestic product;
- net debt;
- net debt per capita; and
- net debt as a percentage of province's gross domestic product.

Each of these indicators provides useful insight into the sustainability of a government's revenue raising and spending practices.

Annual surplus or deficit

A surplus occurs when the amount of annual revenue available is more than expenses in the same year. A deficit occurs when the amount of expenses is more than the amount of revenue available in the same year. It is an indicator of whether a government is living within its means.

Observations

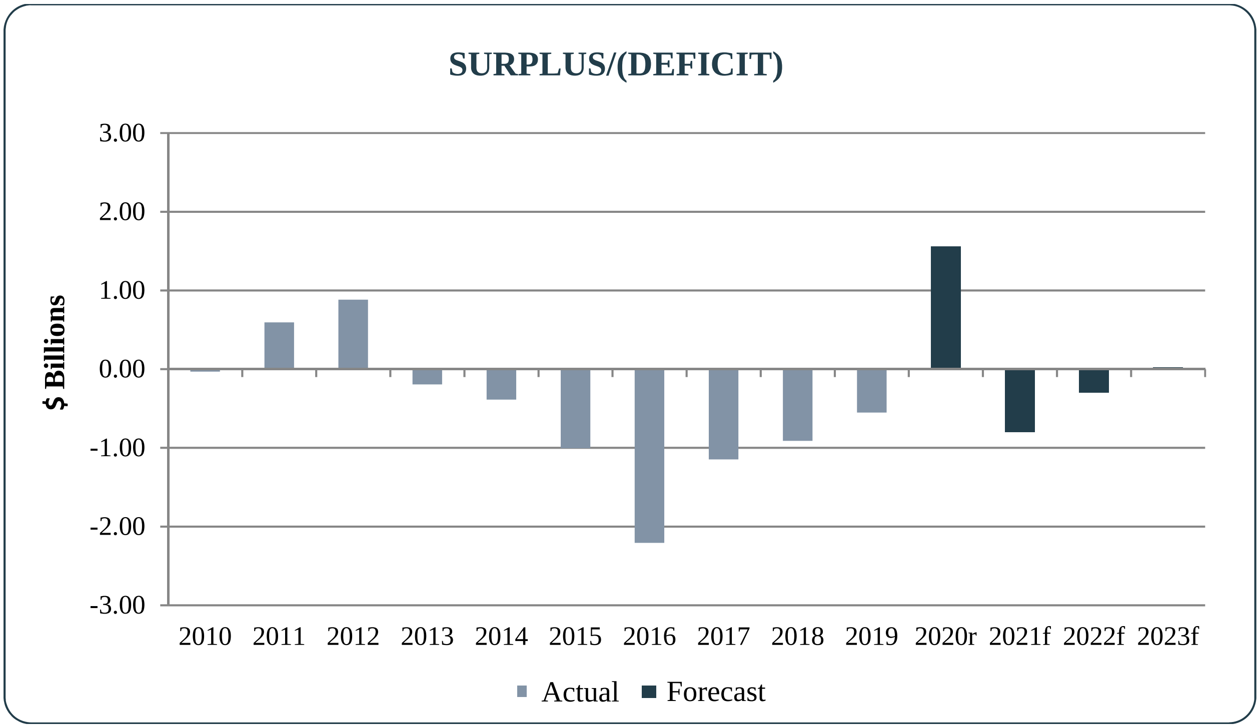
1. **The Province reported a deficit of $0.55 billion in 2018-19. While this is an improvement over the deficits reported in recent years, it is still a significant deficit.**

2. **The Province has incurred annual deficits over the last seven years (2012-13 to 2018-19) totaling $6.4 billion.**

3. **The Province has revised its forecasted surplus for 2019-20 downward from $1.92 billion to $1.56 billion primarily in anticipation of lower oil revenues and revised tax estimates. The revised forecasted surplus of $1.56 billion is primarily the result of the Federal/Provincial Hibernia Dividend Backed Annuity Agreement announced in April 2019. This agreement will result in a guaranteed stream of additional net cash flows from the Federal government of $2.5 billion to be received over the period 2019-20 to 2055-56. Due to the nature of this agreement, the Province will recognize this $2.5 billion revenue upfront in 2019-20. In absence of this agreement, the Province would have projected a deficit of over $0.9 billion.**

   Our Office continues to work with the Province's Office of the Comptroller General in the assessment of the accounting treatment for the funding provided pursuant to the Hibernia Dividend Backed Annuity Agreement. In particular, the net cash flows of $2.5 billion to be received by the Province over the period 2019-20 to 2055-56 includes provincial taxes related to the Federal government's interest in the Hibernia project that will be payable to the Province over this same period of time. Canadian Public Sector Accounting Standards require tax revenues to be recognized when the taxable event occurs (i.e. recorded in each year as the taxable income is earned).

   For 2020-21 and 2021-22, the Province forecasts deficits of $0.8 billion and $0.3 billion respectively before returning to a small surplus in 2022-23.



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

2018-19

For the year ended March 31, 2019, the Province recorded a deficit of $0.55 billion, which was $0.13 billion less than predicted in Budget 2018. While this is an improvement over the deficits reported in recent years, it is still a significant deficit.

Over the past 10 years, the Province recorded a cumulative net deficit (adding annual surpluses or deficits for each of these years) of $5.0 billion. The cumulative deficit for the past five years is $5.8 billion, representing a downward or deteriorating trend. The Province has incurred annual deficits over the last seven year period 2012-13 to 2018-19 totaling $6.4 billion.

2019-20 to 2022-23

The Province has revised its forecasted surplus for 2019-20 downward from $1.92 billion to $1.56 billion primarily in anticipation of lower oil revenues and revised tax estimates. The revised forecasted surplus of $1.56 billion is primarily the result of the Federal/Provincial Hibernia Dividend Backed Annuity Agreement announced in April 2019. This agreement will result in a guaranteed stream of additional net cash flows from the Federal government of $2.5 billion to be received over the period 2019-20 to 2055-56. Due to the nature of this agreement, the Province will recognize this $2.5 billion revenue upfront in 2019-20. In the absence of this agreement, the Province would have projected a deficit of over $0.9 billion.

Canada Hibernia Holding Corporation (CHHC), wholly owned by the Federal Government, has an 8.5 per cent working interest in the Hibernia offshore oil project. CHHC is subject to the Income Tax Act and is required to pay provincial taxes to the Province on an annual basis.

The net cash flows of $2.5 billion to be received by the Province over the period 2019-20 to 2055-56 includes the provincial taxes that will be payable by CHHC to the Province over this same period of time. Currently, the Province is planning to recognize the $2.5 billion, including the CHHC tax revenues, in 2019-20. However, Canadian Public Sector Accounting Standards require tax revenues to be recognized when the taxable event occurs (i.e. recorded in each year as the taxable income is earned by CHHC).

Our Office continues to work with the Province's Office of the Comptroller General in the assessment of the accounting treatment for the funding provided pursuant to the Hibernia Dividend Backed Annuity Agreement.

For 2020-21 and 2021-22, the Province forecasts deficits of $0.8 billion and $0.3 billion respectively before returning to a small surplus in 2022-23. A discussion on risks to Government's forecast is outlined at the end of this chapter.

Surplus/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 Gross Domestic Product (GDP). GDP is the measure of the value of goods and services produced by the economy. This indicator relates the deficit to the size of the Province's economy and provides a basis for comparison of financial performance among other provincial jurisdictions.

Observations

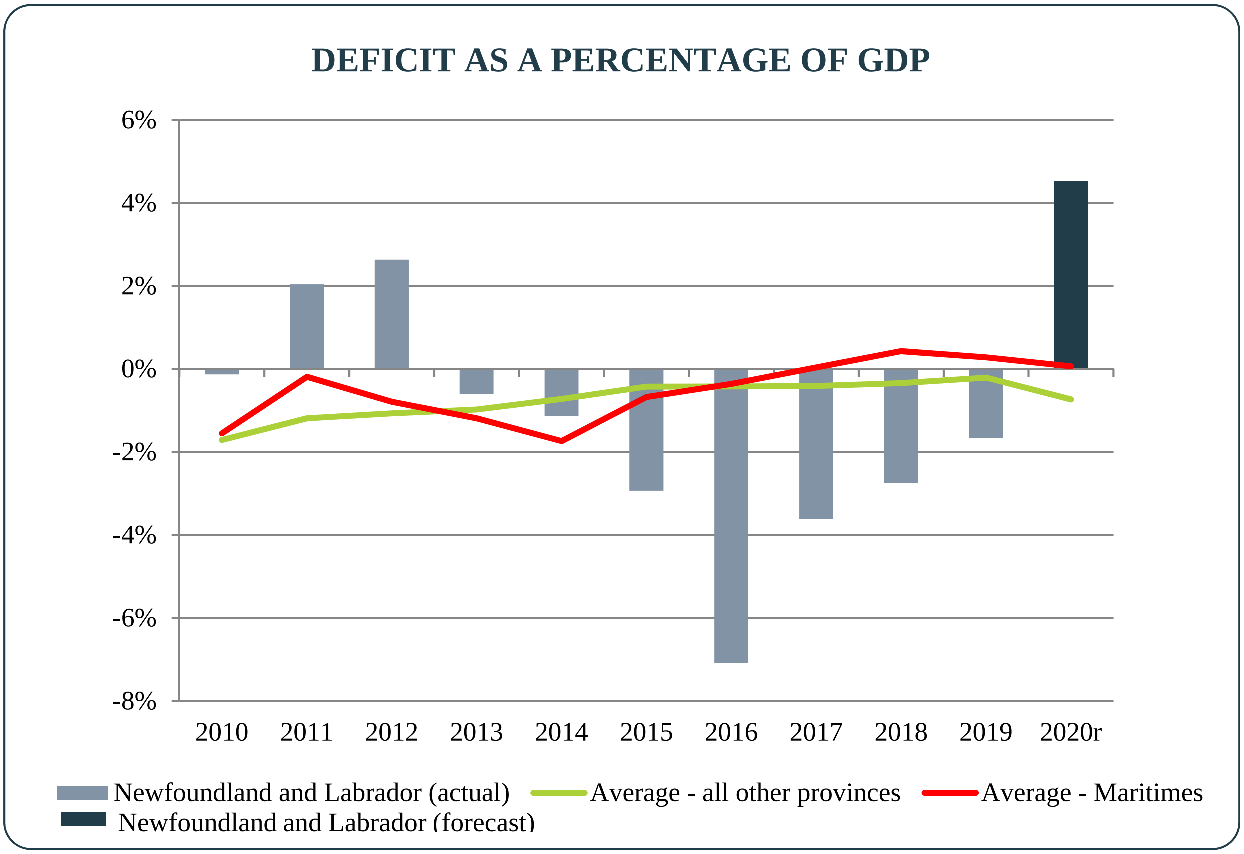
4. **Newfoundland and Labrador's deficit as a percentage of GDP for 2018-19 is 1.7 per cent, the second highest in Canada.**

5. **The forecast surplus as a percentage of GDP for 2019-20 is 4.5 per cent. This improvement is primarily the result of additional one-time revenue of $2.5 billion recognized during the year from the Hibernia Dividend Backed Annuity Agreement.**

2018-19 and 2019-20

Newfoundland and Labrador's deficit as a percentage of provincial GDP for 2018-19, at 1.7 per cent, is the second highest in Canada.

The Province's forecasted surplus as a percentage of GDP for 2019-20 is expected to improve to 4.5 per cent which is favourable compared to both the average of all other provinces and the Maritimes. This improvement is primarily the result of recognizing the additional one-time revenue of $2.5 billion from the Hibernia Dividend Backed Annuity Agreement. Also, there is a deterioration of the operating results expected for several other provinces.



Source: Economic Outlook – all provinces (forecast); Statistics Canada, Table: 36-10-0222-01, Gross domestic product, expenditure-based, provincial and territorial, annual (x 1,000,000) (actual); Public Accounts – all provinces (actual); Department of Finance (forecast)

Net Debt

Net Debt represents all the liabilities of the Province less its financial assets and indicates whether there are enough financial assets to cover the liabilities for future generations. Net Debt is a commonly used indicator 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 Government Business Partnerships (GBPs). GBEs of the Province of Newfoundland and Labrador include Nalcor and its subsidiaries and the Newfoundland and Labrador Liquor Corporation. The Province's only GBP is its 25 per cent equity interest in the Atlantic Lottery Corporation. GBEs and GBPs generate revenue for the Provincial treasury through the sale of goods and services.

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.

Observations

6. **Net Debt of the Province at March 31, 2019, was $15.4 billion, an increase of $0.7 billion from the previous year and the highest level in the Province's history.**

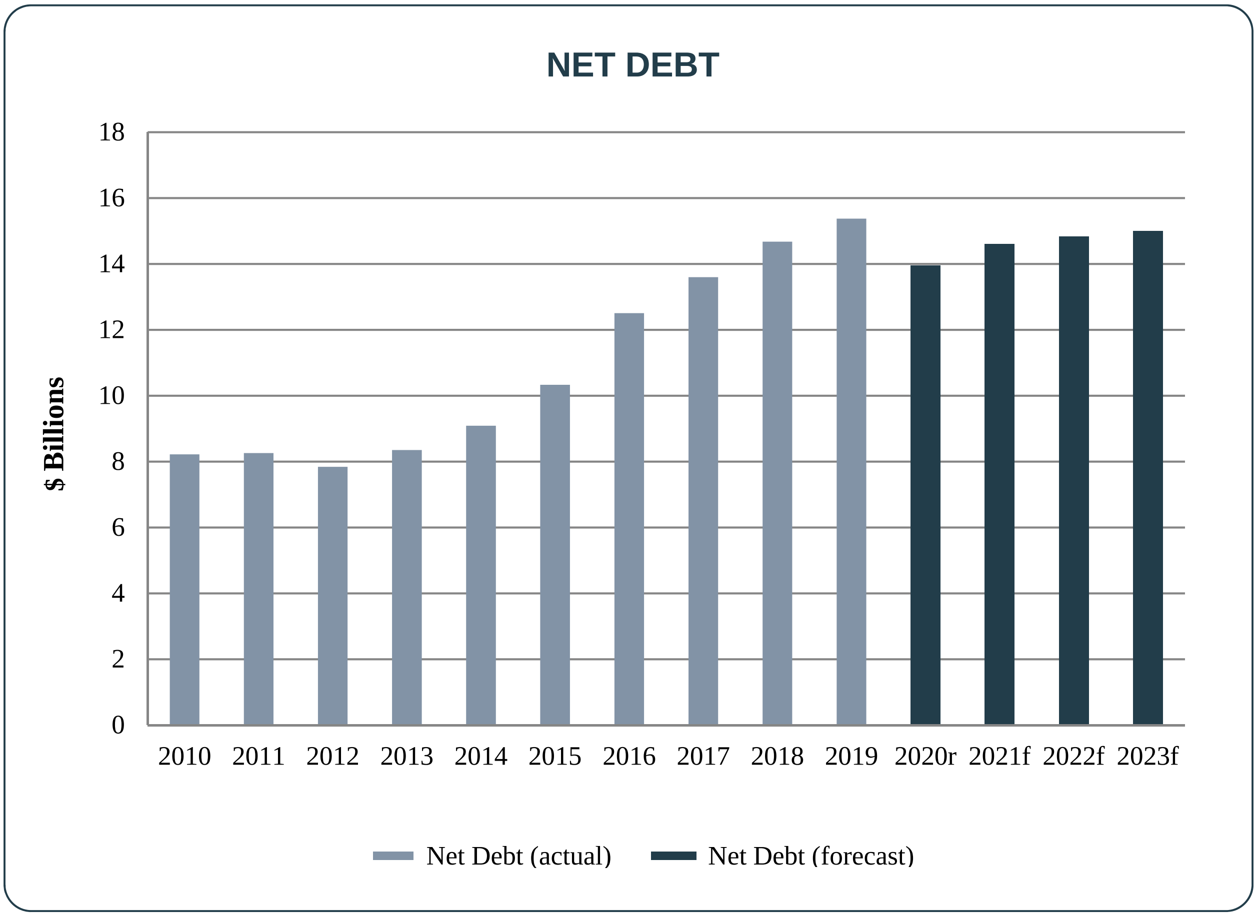
7. **At March 31, 2019, Net Debt had increased by approximately $7.5 billion from its low point in 2011-12, primarily the result of deficits totaling $6.4 billion in the 2012-13 through 2018-19 fiscal years plus the impact of tangible capital asset acquisitions during this period.**

8. **Net Debt is expected to decrease to $13.95 billion by March 31, 2020. This is primarily the result of the additional one-time revenue of $2.5 billion from the Hibernia Dividend Backed Annuity Agreement recognized in 2019-20. Net Debt is projected to increase to $15.0 billion by March 31, 2023 due to net deficits from 2021 to 2023, combined with spending on infrastructure.**

2018-19

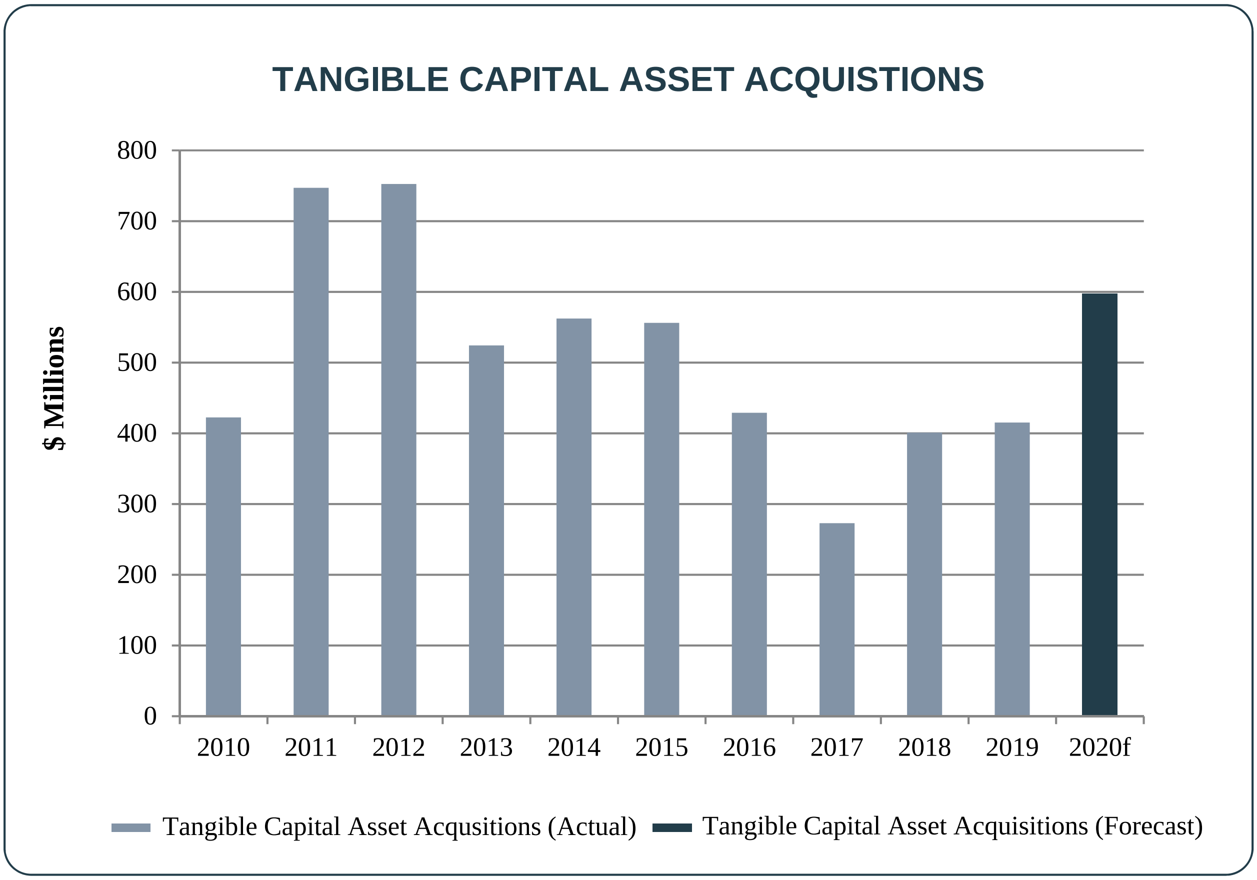
Net Debt of the Province at March 31, 2019 was $15.4 billion, an increase of $0.7 billion from the previous year and the highest level in the Province's history.

At March 31, 2019, Net Debt had increased by approximately $7.5 billion from its low point in 2011-12, primarily the result of deficits totaling $6.4 billion in the 2012-13 through 2018-19 fiscal years plus the impact of tangible capital asset acquisitions during this period.



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

Tangible capital assets (infrastructure) represent the physical infrastructure of the Province (excluding those owned by GBEs and GBPs) and include 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.



Source: Public Accounts; Department of Finance (forecast)

In response to the recession of 2008 and 2009, annual spending on tangible capital assets spiked significantly through 2010 to 2012 as the federal and provincial governments supported the economy through spending on infrastructure. Annual infrastructure spending since 2012 has declined with 2017 reaching near pre-recession levels. In 2019, infrastructure spending levels increased by $14.2 million from 2018.

2019-20 to 2022-23

Net Debt is expected to decrease to $13.95 billion by March 31, 2020, largely driven by the recognition of additional one-time revenue of $2.5 billion from the Hibernia Dividend Backed Annuity Agreement in 2019-20. Infrastructure spending in 2020 is projected to increase by $182.7 million from 2019 levels which is part of the Province's $2.4 billion infrastructure plan over the five years 2019-2023. This $2.4 billion is net of federal funding.

The 2019 Fiscal and Economic Update did not provide any further update to expected Net Debt beyond 2019-20. Budget 2019 projected Net Debt to increase to $15.0 billion by 2022-23 due to net deficits from 2021 to 2023, combined with spending on infrastructure.

Investments in infrastructure and programs will have to continue to be prioritized to allow a prudent pace of deficit reduction and timely stabilization of the net debt burden.

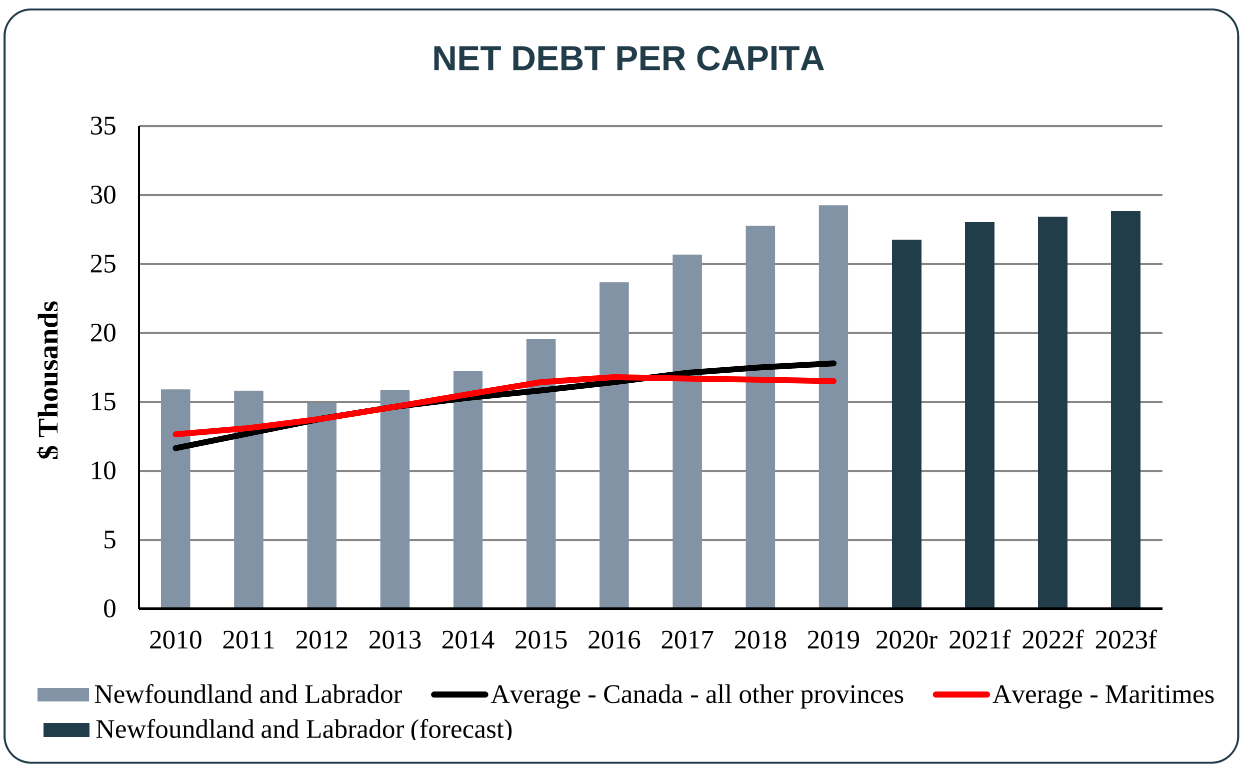
Net Debt per Capita

Net Debt per capita is a measure of the burden of the Province's debt attributed to each resident of the Province.

Observations

9. At March 31, 2019, Net Debt per capita increased to $29,250 - the highest in the Province's history. This represents a significant financial burden attributed to each and every Newfoundlander and Labradorian.

10. Consistent with the expected decrease in Net Debt, Net Debt per capita is expected to decrease to $26,748 by March 31, 2020. This is primarily attributable to recognizing the additional one-time revenue of $2.5 billion from the Hibernia Dividend Backed Annuity Agreement in 2019-20. Net Debt per capita will increase again during the period 2020-21 through 2022-23 due to projected net deficits and declining population. Net debt per capita is projected to be $28,812 by 2023, once again approaching the 2019 level of $29,250.



Source: Public Accounts – all provinces (actual); Statistics Canada, Table: 17-10-0005-01, Population estimates on July 1st by age and sex (actual); Department of Finance (forecast)

In 2012, the Province's Net Debt per capita had reached its lowest point at $14,927. 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 and the Maritimes deteriorated during that same period.

At March 31, 2019, Net Debt per capita increased to $29,250, the highest in the Province's history. This represents a significant financial burden attributed to each and every Newfoundlander and Labradorian.

Consistent with the expected decrease in Net Debt, Net Debt per capita is expected to decrease to $26,748 by March 31, 2020. This is primarily attributable to recognizing the additional one-time revenue of $2.5 billion from the Hibernia Dividend Backed Annuity Agreement in 2019-20. Net Debt per capita will increase again during the period 2020-21 through 2022-23 due to projected net deficits and declining population. Net debt per capita is projected to be $28,812 by 2023, once again approaching the 2019 level of $29,250.

Net Debt as a percentage of GDP

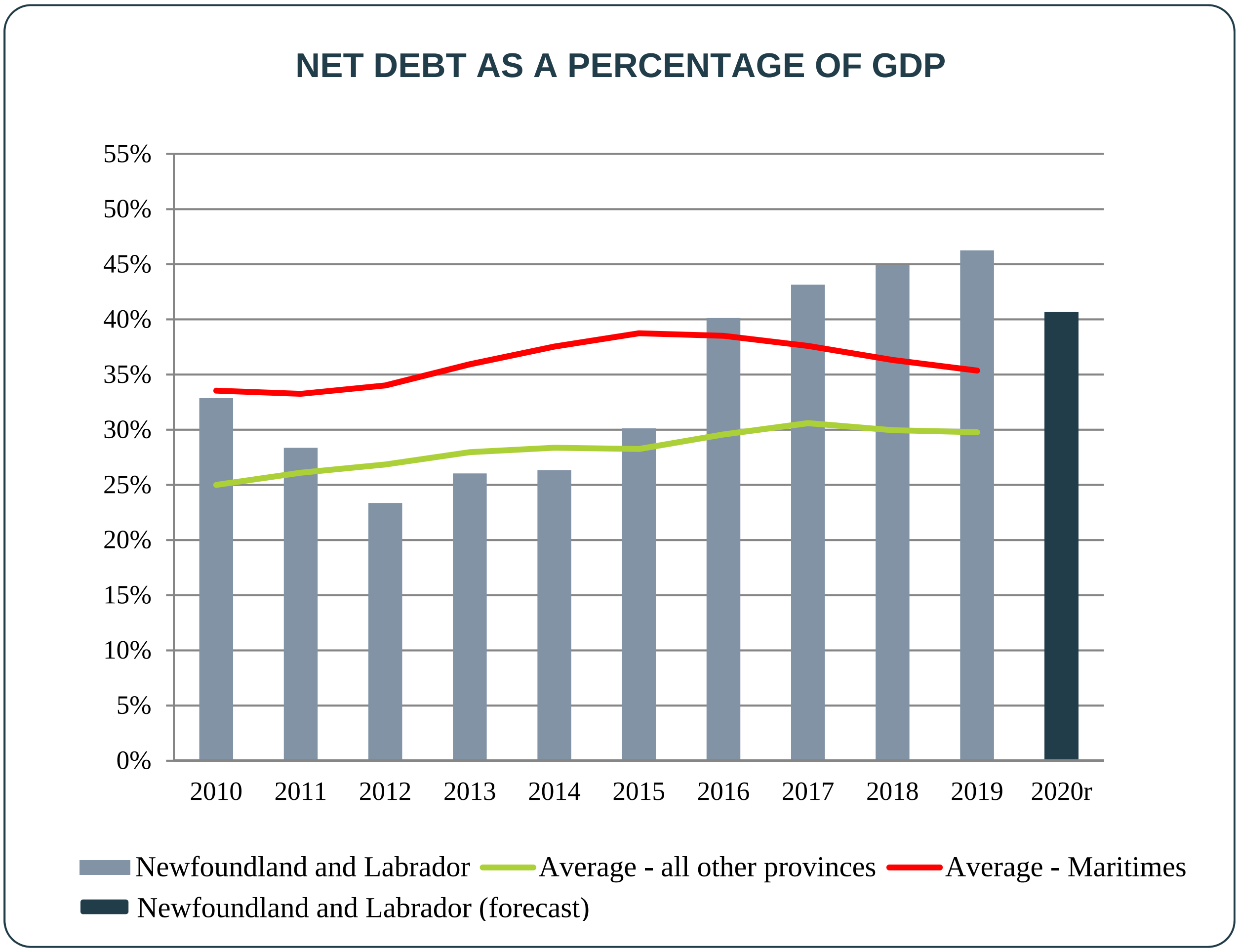
Another commonly used indicator to measure a province's financial position is Net Debt as a percentage of GDP. This indicator is perhaps the most widely used and relates provincial Net Debt to the size of the economy that supports the debt level. Because it is a relative measure, it is also used to compare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

Observations

11. The Province's Net Debt as a percentage of GDP has fluctuated over the last ten years - from a low of 23.4 per cent in 2012 climbing to a high of 46.3 per cent at March 31, 2019 - and is now significantly higher than the average of 29.8 per cent of all other provinces.

12. By March 31, 2020, the Province's Net Debt as a percentage of GDP is forecasted to improve to 40.7 per cent. This forecasted improvement is primarily attributable to recognizing the additional one-time revenue in 2019-20 from the Hibernia Dividend Backed Annuity Agreement. However, the expectation of continued deficits and modest GDP growth beyond 2019-20 could cause the ratio of Net Debt to GDP to increase again in the future.



Source: Economic Outlook – all provinces (forecast); Statistics Canada, Table: 36-10-0222-01, Gross domestic product, expenditure-based, provincial and territorial, annual (x 1,000,000) (actual); Public Accounts – all provinces (actual); Department of Finance (forecast)

Over the past 10 years, Net Debt as a percentage of GDP averaged 34.1 per cent with a low of 23.4 per cent at March 31, 2012. For fiscal 2012, 2013 and 2014, the Net Debt to GDP ratio of Newfoundland and Labrador was lower than the average of all other provinces and well below the average of the Maritimes. Over the past five years, the Net Debt as a percentage of GDP averaged 40.9 per cent - an upward and deteriorating trend.

At March 31, 2019, the Province's Net Debt as a percentage of GDP climbed to 46.3 per cent, which is significantly higher than the average of 29.8 per cent for all other provinces and higher than the average of 35.4 per cent for the Maritimes. By March 31, 2020, the Province's Net Debt as a percentage of GDP is forecasted to improve to 40.7 per cent. This forecasted improvement is primarily attributable to recognizing the additional one-time revenue in 2019-20 from the Hibernia Dividend Backed Annuity Agreement. However, the expectation of continued deficits and modest GDP growth beyond 2019-20 could cause the ratio of Net Debt to GDP to increase again in the future.

Flexibility

Flexibility is the degree to which a government can increase its financial resources to respond to rising commitments, by either expanding its revenues or increasing its debt. Flexibility indicators include debt expenses as a percentage of total revenue.

Debt expenses as a percentage of total revenue

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 existing or new government programs and services.

Observations

13. Over the past 10 years, debt expenses as a percentage of revenue averaged 12.0 per cent with a low of 9.0 per cent for 2012. Over the past five years, debt expenses as a percentage of revenue averaged 13.3 per cent - an upward and deteriorating trend. Debt expenses as a percentage of revenue for 2018-19 are 13.3 per cent.

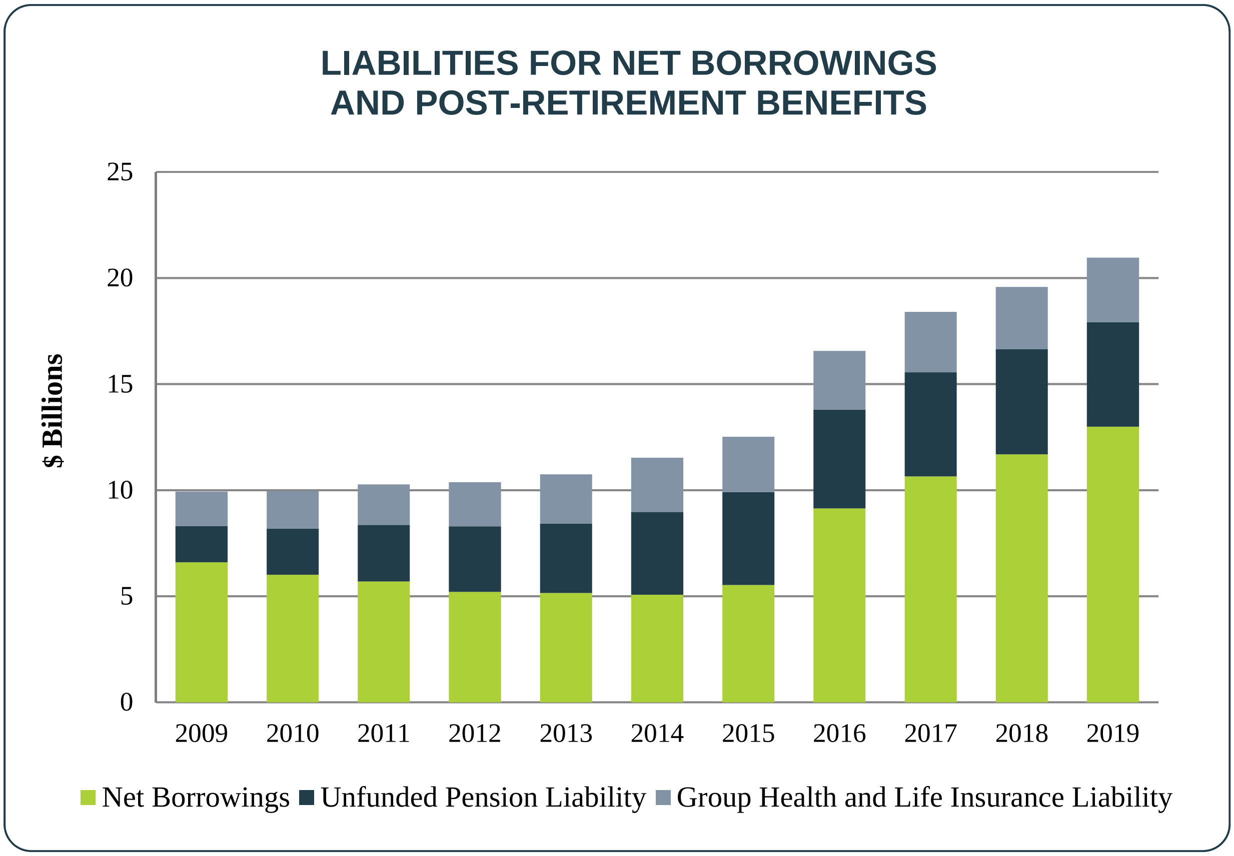
14. Between 2019-20 and 2022-23, Budget 2019 estimated that 12.5 per cent of every dollar of revenue generated will be allocated to debt expense. This decrease to 12.5 per cent is primarily attributable to recognizing the $2.5 billion in revenue in 2019-20 from the Hibernia Dividend Backed Annuity Agreement. Money allocated to servicing debt is money that is not available to fund programs and services.

15. Over the period 2019-20 to 2022-23, the Province expects to borrow up to $4.8 billion in the capital markets, which will have associated debt expenses. Borrowings are required 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.**

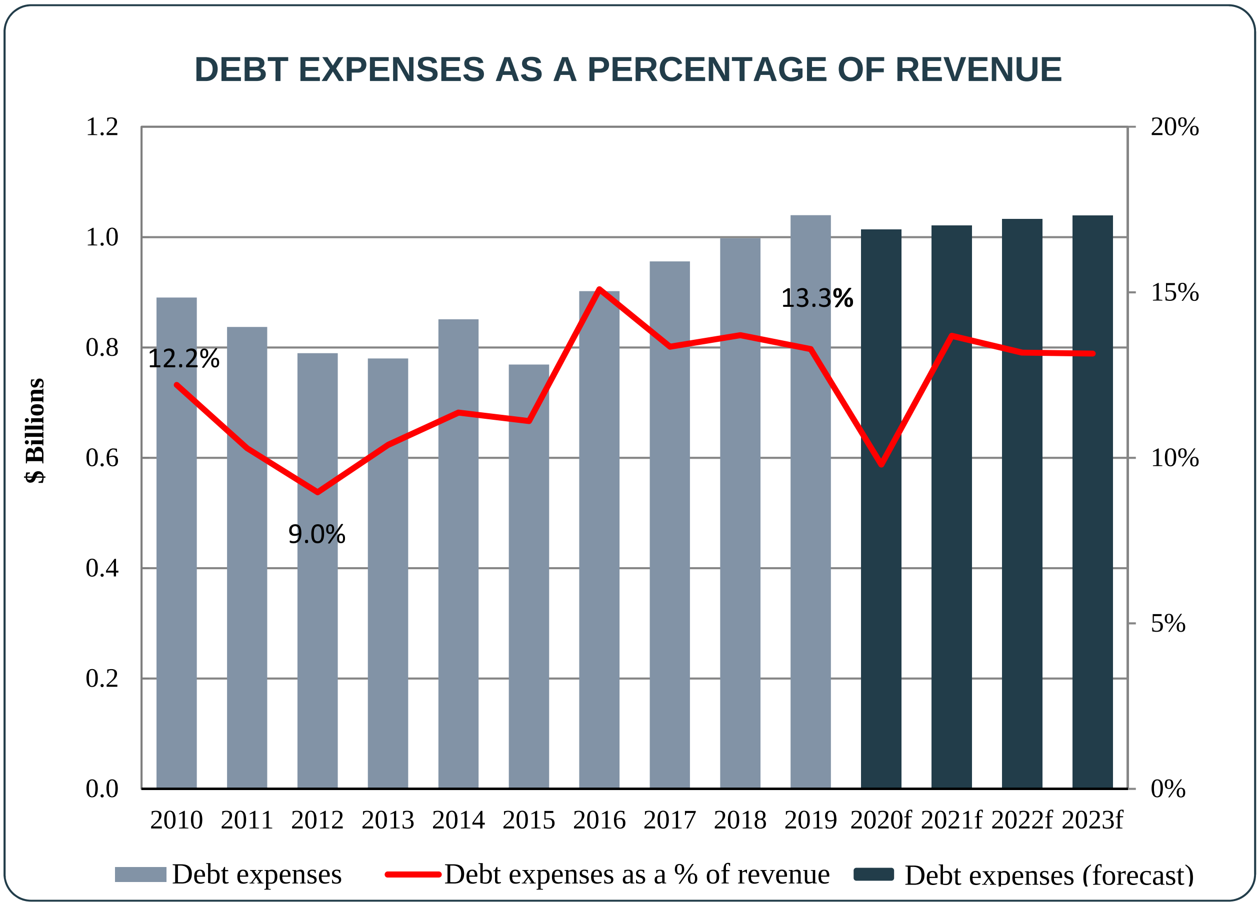
Government incurs interest costs on its borrowings, as well as on its liabilities related to employee post-retirement benefits. At March 31, 2019, Government borrowings (net of sinking funds), unfunded pension liability and unfunded group health and life insurance retirement benefits liability totaled $21.0 billion, an increase of $11.0 billion or approximately 111 per cent over the last ten years.

The net borrowings do not include the borrowings of Government business enterprises and partnership (Nalcor, Newfoundland Labrador Liquor Corporation and the Province's share of Atlantic Lottery Corporation) as these entities are considered investments. Thus, their assets and liabilities are recorded as equity in the Consolidated Summary Financial Statements.



Source: Public Accounts

Over the last 10 years, annual debt expense averaged $881 million and debt expenses as a percentage of revenue averaged 12.0 per cent with a low of 9.0 per cent for 2012. Over the past five years, debt expenses as a percentage of revenue averaged 13.3 per cent - an upward and deteriorating trend. Debt expenses as a percentage of revenue for 2018-19 are 13.3 per cent.



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

Budget 2019 forecast annual debt servicing expenses to average $1.0 billion between 2019-20 and 2022-23. Debt expenses as a percentage of revenue are estimated to average 12.5 per cent between 2019-20 and 2022-23. This decrease to 12.5 per cent is primarily attributable to recognizing the $2.5 billion in revenue in 2019-20 from the Hibernia Dividend Backed Annuity Agreement.

In recent years, Government has implemented measures to reduce liabilities for post-retirement benefits. These measures included, for example, pension reform to address the significant growing unfunded pension liability, elimination of severance moving forward and amendments to other post-retirement benefits.

Over the period 2019-20 to 2022-23, the Province expects to borrow up to $4.8 billion in the capital markets, which will have associated debt expenses. This borrowing will be used to:

- Re-finance existing debt as it comes due.
- Satisfy the required commitments 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.

Vulnerability

Vulnerability is the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside of its control or influence. Important vulnerability indicators include:

- Federal Government and own source revenues compared to total revenues; and
- offshore oil royalties as a percentage of own source revenues.

Federal Government and own source revenues compared to total revenues

A comparison of Federal Government and own source revenues to total revenues reflects how dependent Government is on these different revenue sources for financing its programs and services and thus, how vulnerable Government is to changes in these revenue sources.

Observations

16. Over the ten-year period 2010 to 2019, the Province has become more reliant on own source revenues and less reliant on Federal revenues – from 78.8 per cent for own source revenues in 2010 to a high of 86.8 per cent in 2013, with an average of 84.2 per cent over the last five years. Federal revenue as a percentage of total revenue has seen a downward trend from 21.2 per cent in 2010 to a low of 13.2 per cent in 2013, with an average of 15.8 per cent over the last five years.

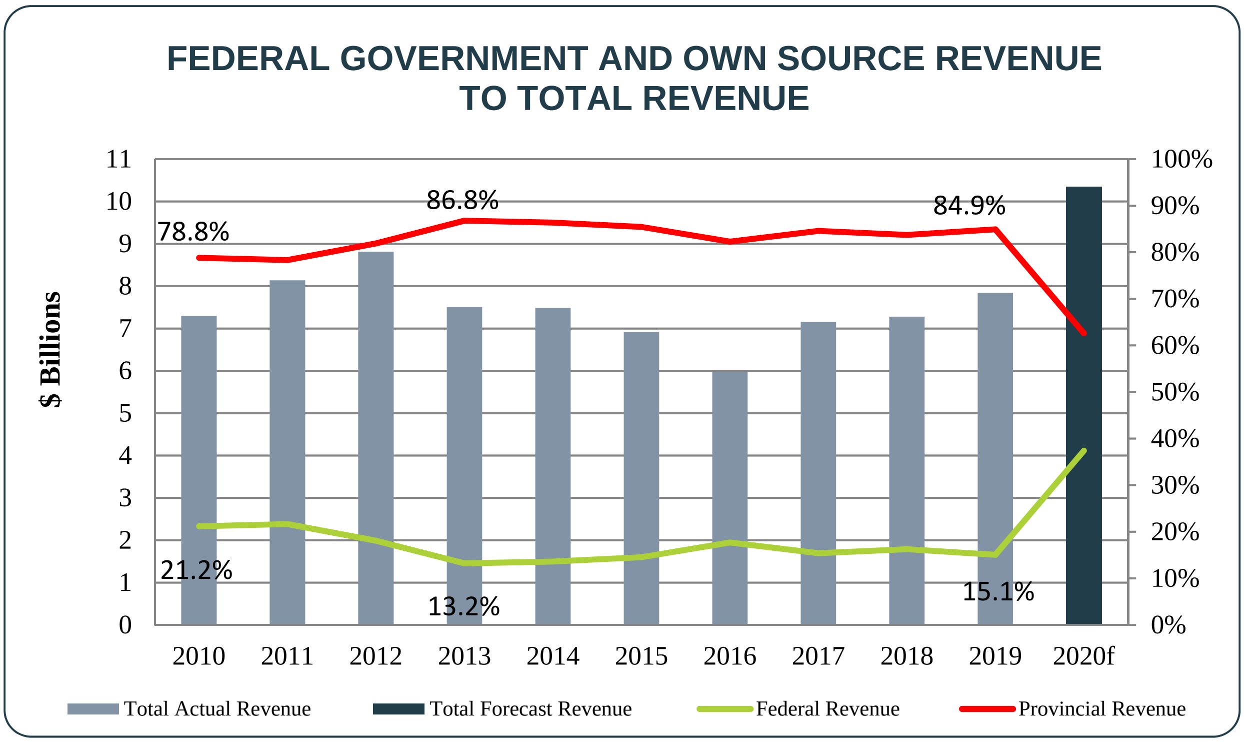
17. Own source revenues include oil royalties that are subject to volatile pricing and production swings and change in exchange rates – factors outside of Government's control. Thus, there is vulnerability associated with reliance on this source of revenue to finance existing programs and services. Continued efforts to diversify the economy over the medium to longer-term timeframe, and thus reducing reliance on oil royalties, will remain important.

Federal revenues primarily consist of Health and Social Transfers and cost-shared programs. Newfoundland and Labrador has not received any equalization payments since 2008. However, equalization transfers are affected by each province's performance in relation to the performance of other provincial economies, and therefore are subject to change.

Over the ten-year period from 2010 to 2019, Federal revenue as a percentage of total revenue has seen a downward trend from 21.2 per cent in 2010 to a low of 13.2 per cent in 2013. Since 2013, this percentage has generally remained consistent with some modest increases, with an average of 15.8 per cent over the last five years.

During this same period, own source revenues as a percentage of total revenue has seen a corresponding increase from 78.8 per cent in 2010 to 86.8 per cent in 2013, with an average of 84.2 per cent over the last five years. Thus, the Province has become more reliant on its ability to generate own source revenues to finance its programs and services.

Own source revenues include oil royalties, however, which are subject to volatile pricing and production swings and changes in exchange rates that are outside of Government's control. Thus, there is vulnerability associated with reliance on this source of revenue to finance programs and services. For example, in 2016, as a result of production declines and oil prices, oil royalties declined $1.0 billion from 2015. The impact of this vulnerability from oil prices, production and exchange rates is outlined in more detail below. Continued efforts by Government to diversify the economy in the medium to longer-term timeframe, and thus reducing reliance on oil royalties, will remain important.



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

Due to the recognition in 2019-20 of the additional one-time revenue of $2.5 billion from the Hibernia Dividend Backed Annuity Agreement, the 2020 forecast at Budget 2019 shows the related sharp increase in the percentage of Federal government source revenue to total revenue (increase to 37.5 per cent) and corresponding decrease in own source revenue (decrease to 62.5 per cent).

Oil royalties as a percentage of revenues

Oil royalties are a significant revenue source for the Province but are subject to volatility in commodity prices, exchange rates and oil production – factors that are outside of Government's control. Therefore, changes in these factors can result in significant differences between forecast revenues and actual revenues. This is an important fiscal planning consideration for Government so that expenditure levels are not built to be reliant on oil royalties.

Observations

18. For the ten-year period 2009-10 to 2018-19, oil royalties accounted for, on average, 21.5 per cent of revenues (including Atlantic Accord revenues) with a peak in 2011-12 of 31.7 per cent. For the last five-year period from 2014-15 to 2018-19, this had dropped to, on average, 14.3 per cent. For 2018-19, oil royalties had dropped to 13.8 per cent of revenues. The volatility associated with oil royalties is an important fiscal planning consideration for Government so that expenditure levels are not built to be reliant on this revenue source.

19. Annual production of offshore oil, while fluctuating significantly, has shown an overall downward trend since 2007-08 when production was 133.8 million barrels. Production fell to a low of 61.7 million barrels in 2015-16, increasing to 85.0 million barrels in 2018-19.

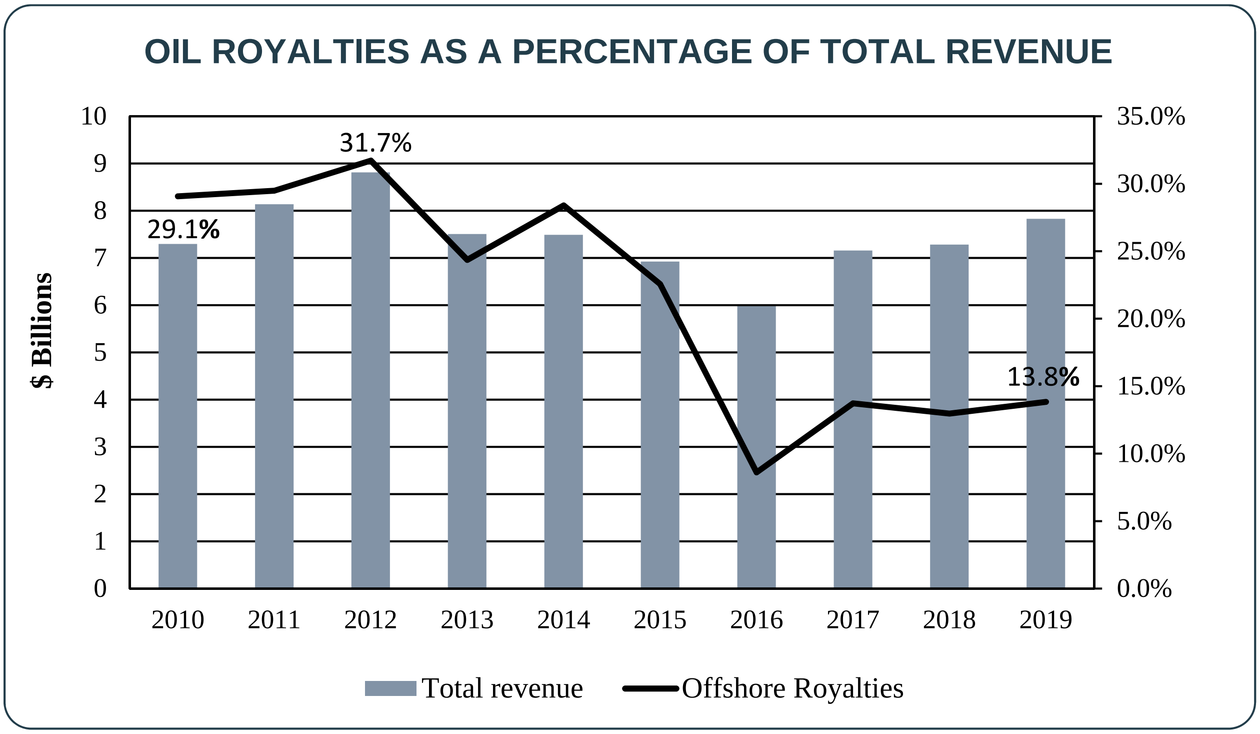
20. Budget 2019 forecast production for 2019-20 at 99.4 million barrels with continued production increases each year reaching 115.2 million barrels in 2022-23. This increase is primarily as a result of increased production from the Hebron field.

21. The average annual price of Brent Crude peaked in 2011-12 at $US114.58 per barrel and has declined since that time. In 2018-19, prices trended upward for most of the year compared to the previous year and the price of Brent crude averaged $US70.40 per barrel.

22. The 2019 Fiscal and Economic Update revised the forecasted price of Brent Crude downward for 2019-20 from an average of $US65 per barrel to $US63. Budget 2019 forecast an average of $US68 per barrel in 2020-21 with steady annual increases to $US71 per barrel by 2022-23. If these price increases do not materialize or the Canadian dollar is stronger than forecast, the Province will have increased pressure to achieve its surplus/deficit targets. The 2019 Fiscal and Economic Update, for the timeframe December 2019 to March 2020, estimated that from a sensitivity perspective:

- **Every US$1.00 decline in oil price would result in a loss of revenue of CAD$7.7 million (CAD$7.7 million in additional revenue for every US$1.00 increase in oil prices).**
- **Every one-cent increase in the CAD/USD exchange rate would result in a loss of revenue of CAD$6.2 million (CAD$6.2 million in additional revenue for every one-cent decrease)**

For the ten-year period 2009-10 to 2018-19, oil royalties accounted for, on average, 21.5 per cent of revenues (including Atlantic Accord revenues) with a peak in 2011-12 of 31.7 per cent. For the last five-year period from 2014-15 to 2018-19, this had dropped to, on average, 14.3 per cent. For 2018-19, oil royalties represented 13.8 per cent of revenues.



Note: Total revenue includes revenues received under the Atlantic Accords.
Source: Public Accounts

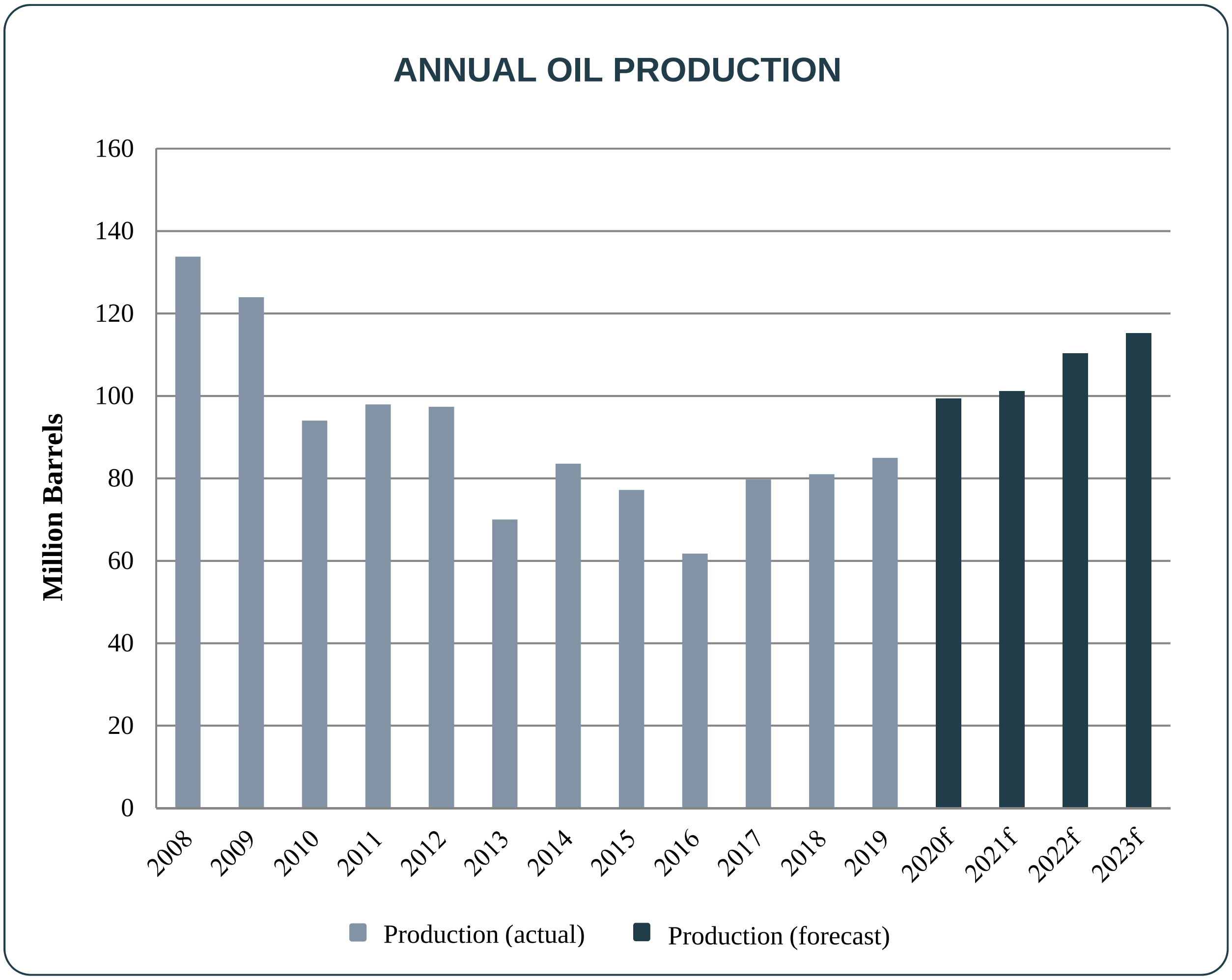
Oil Production

2018-19

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, while fluctuating significantly, has been on a general downward trend. Production fell to a low of 61.7 million barrels in 2015-16, increasing to 85.0 million barrels in 2018-19.

2019-20 to 2022-23

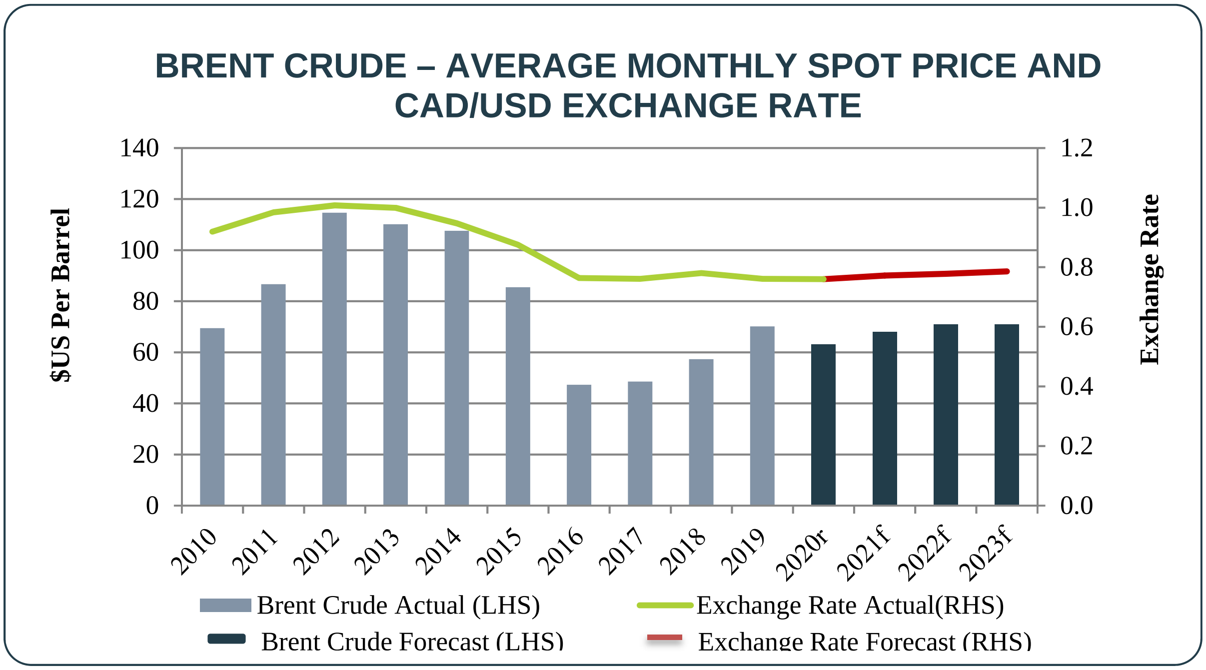
Budget 2019 forecast oil production to increase in 2019-20 to 99.4 million barrels with continued production increases each year to 2022-23. The increase in production is attributed, primarily, to the commencement of production from the Hebron field, which produced first oil on November 27, 2017. By 2022-23, total oil production is forecast to be 115.2 million barrels.



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

Oil Price and Exchange Rate

The price of Brent Crude (quoted in US dollars), and the Canada-US exchange rate are subject to significant fluctuation that can have a significant impact on oil revenues.



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

2018-19

The average annual price of Brent Crude peaked in 2011-12 at $US114.58 per barrel. From 2011-12, the average price steadily declined until 2015-16 when it reached $US47.42 per barrel. The average annual price has increased since that time and in 2018-19, the average price of Brent crude was $US70.40 per barrel.

The average annual Canada-US (CAD/USD) exchange rate also peaked in 2011-12 at 1.008. From 2011-12, the exchange rate steadily declined until 2016-17 when it reached 0.761. The average annual exchange rate increased to 0.780 in 2017-18 and has declined again to 0.761 in 2018-19.

2019-20 to 2022-23

Budget 2019 forecast the price of Brent crude to be $US65 per barrel for 2019-20; however, the 2019 Fiscal and Economic Update has since revised the forecasted price for 2019-20 to $US63 per barrel. The price of Brent crude has averaged $US64.38 from April to November 2019. Some risk remains around oil prices for the remainder of the fiscal year. Budget 2019 forecast the average CAD/USD exchange rate at 0.77 for 2019-20, which was revised in the 2019 Fiscal and Economic Update to 0.76. The CAD/USD exchange rate has averaged 0.75 from April to November 2019. The 2019 Fiscal and Economic Update, for the timeframe December 2019 to March 2020, estimated that from a sensitivity perspective:

- Every US$1.00 decline in oil price would result in a loss of revenue of CAD$7.7 million (CAD$7.7 million in additional revenue for every US$1.00 increase in oil price).
- Every one-cent increase in the CAD/USD exchange rate would result in a loss of revenue of CAD$6.2 million (CAD$6.2 million in additional revenue for every one-cent decrease).

The Province is forecasting the price of Brent crude to average $US68 in 2020-21 and expects to see steady annual increases to $US71 per barrel by 2022-23. The average annual exchange rate is forecast at 0.772 in 2020-21 with steady annual increases to 0.786 by 2022-23. If these price increases do not materialize or the Canadian dollar is stronger than forecast, the Province will have increased pressure to achieve its surplus/deficit targets.

Of greater risk is the forecast from 2020-21 to 2022-23. The farther in the future the forecast extends, 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.

Other Financial Highlights - Revenues and Expenses

Observations

23. Over the ten-year period 2009 to 2019, total expenses have grown steadily from $6.3 billion to $8.4 billion, an increase of $2.1 billion or 33.0 per cent. During this same period, while revenues have fluctuated significantly, for the year ended March 31, 2019, revenues totaled $7.8 billion – a decrease of $805 million or 9.0 per cent from 2008-09. Deficits have been recorded in the last seven years from 2013-2019.

24. The composition of the revenues have changed significantly between 2009 and 2019. There has been a significant decline in revenues from oil royalties and Federal transfers and a moderate decline in corporate income taxes. These declines have been partially offset through increased personal income tax, Harmonized Sales Tax (HST) and other taxes and revenues.

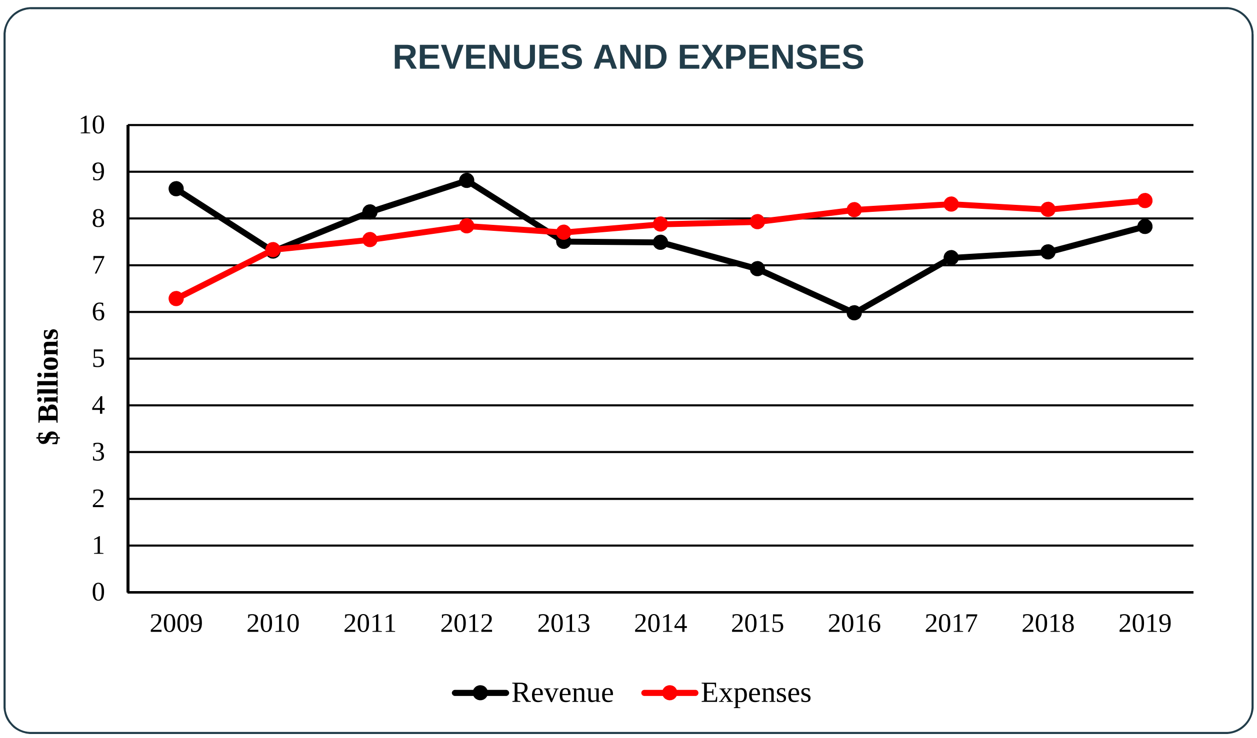
25. During the period 2009 to 2014, total expenses grew by 25.4 per cent or an average of 5.1 per cent per year. While expenses continued to grow from 2014 to 2019, the average rate of growth decreased to 1.3 per cent per year.

26. Program expenses include all those expenses incurred by the Province other than those required to service debt and for the year ended March 31, 2019, represented $7.3 billion of the $8.4 billion in total expenses. Of the $7.3 billion, approximately:

- **71.0 per cent, or $5.2 billion, was directed to the health, education and skills development sectors.**
- **48.0 per cent, or $3.5 billion, was spent on salaries and employee benefits.**

27. The Province of Newfoundland and Labrador generates more revenue, on a per capita basis, than every other province. Newfoundland and Labrador also has one of the highest tax burdens on a per capita basis in the country. However, per capita spending in this Province is substantially higher than per capita spending in every other province and is also higher than the Province's per capita revenues. This suggests that revenue is not the primary issue creating the deficits but the level of spending. Continued emphasis on sustainably reducing the Province's per capita spending will remain important.

Over the ten-year period 2009 to 2019, total expenses have grown steadily from $6.3 billion to $8.4 billion, an increase of $2.1 billion or 33.0 per cent. During this same period, while revenues have fluctuated significantly, for the year ended March 31, 2019, revenues totaled $7.8 billion - a decrease of $805 million or 9.0 per cent from 2008-09. Deficits have been recorded in the last seven years from 2013-2019.



Source: Public Accounts

Revenues

Revenues have fluctuated considerably over the last ten years, from a high of $8.8 billion in 2011-12 to a low of $6.0 billion in 2015-16. Over the ten-year period 2009 to 2019, there was a decrease in revenues of $805 million or 9.0 per cent; however, over the last five years, 2014 to 2019, there has been slight improvement with an increase in revenues of $340 million or 5.0 per cent.

The composition of the revenues have also changed significantly over this ten-year period. There has been a significant decline in revenues from oil royalties and Federal transfers and a moderate decline in corporate income taxes, which have been partially offset through increased personal income tax, Harmonized Sales Tax (HST) and other taxes and revenues.

10-Year/5-Year Trend of Change in Total Revenue ($Millions)

Revenue Type	2008-09	2013-14	2018-19	5-Year Trend (2014-2019)		10-Year Trend (2009-2019)	
				Amount	%	Amount	%
Oil Royalties	$ 2,239	$ 2,126	$ 1,083	$ (1,043)	-49%	$ (1,156)	-52%
Personal Income Tax	900	1,222	1,548	326	27%	648	72%
Corporate Income Tax	520	358	378	20	6%	(142)	-27%
HST and Other Taxes	1,359	1,625	2,118	493	30%	759	56%
Other Revenues	1,056	1,136	1,518	382	34%	462	44%
Federal Transfers	2,558	1,020	1,182	162	16%	(1,376)	-54%
Total Revenues	**$ 8,632**	**$ 7,487**	**$ 7,827**	**$ 340**	**5%**	**$ (805)**	**(9%)**

Source: Public Accounts

Expenses

Expenses, in general, have grown steadily over the last ten years with an overall increase of $2.1 billion or 33.0 per cent. During the period 2009 to 2014, expenses grew by 25.4 per cent or an average of 5.1 per cent per year. While expenses continued to grow from 2014 to 2019, the average rate of growth decreased to 6.4 per cent or 1.3 per cent per year.

Program Expenses

Program expenses include all those expenses incurred by the Province other than those required to service debt and for the year ended March 31, 2019, represented $7.3 billion of the $8.4 billion in total expenses. Since 2008-09, program expenses have grown by $1.8 billion, representing cumulative growth of 32.6 per cent. Over the last five years, program expenses have grown by 4.0 per cent or an average of 0.8 per cent per year, with most increases for social programs and services.

5-Year Trend of Change in Total Expenses ($Millions) [1]				
Expense by Department or Sector	**2013-14**	**2018-19**	**5-Year Trend**	
			Amount	**%**
Health and Community Services	$ 2,850	$ 3,191	$ 341	12%
Advanced Education, Skills and Labour	1,089	1,170	81	7%
Education and Early Childhood Development	833	855	22	3%
General Government Sector and Legislative Branch	1,256	1,030	(226)	-18%
Resource Sector - Other	297	289	(8)	-3%
Social Sector - Other	700	804	104	15%
Total Program Expenses	**7,025**	**7,339**	**314**	**4%**
Debt expenses	851	1,040	189	22%
Total Expenses	**$ 7,876**	**$ 8,379**	**$ 503**	**6%**

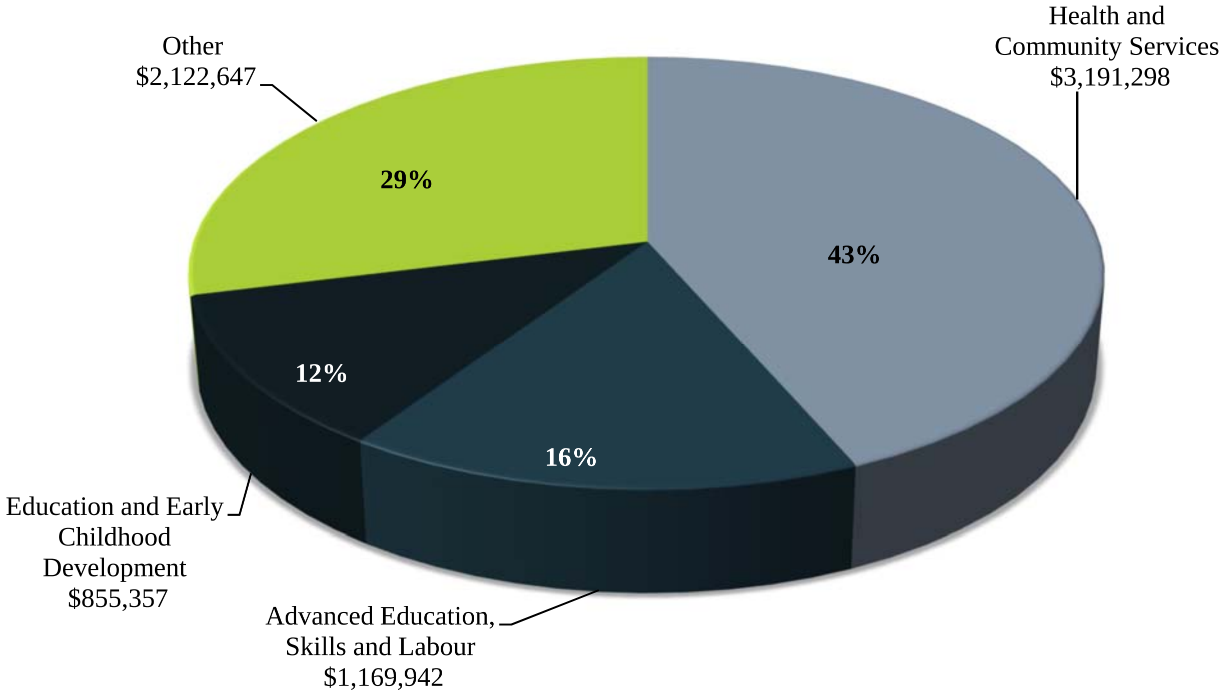
Source: Public Accounts
Note 1: Unlike revenue, due to restructuring of departments, comparative 10-year expenses by department or sector information were not readily available.

Approximately 71.0 per cent of program expenses in 2018-19, or $5.2 billion, were incurred for the following social programs and services:

- $3.2 billion or 43.0 per cent of program expenses were attributed to the Department of Health and Community Services and includes the operations of the four regional health authorities across the Province.

- $2.0 billion or approximately 28.0 per cent of program expenses were attributed to the Departments of Advanced Education, Skills and Labour, and Education and Early Childhood Development. This includes spending on the K-12 system, the university and college, as well as income support and skills development.

PROGRAM EXPENSES BY DEPARTMENT: 2018-19 ($000s)

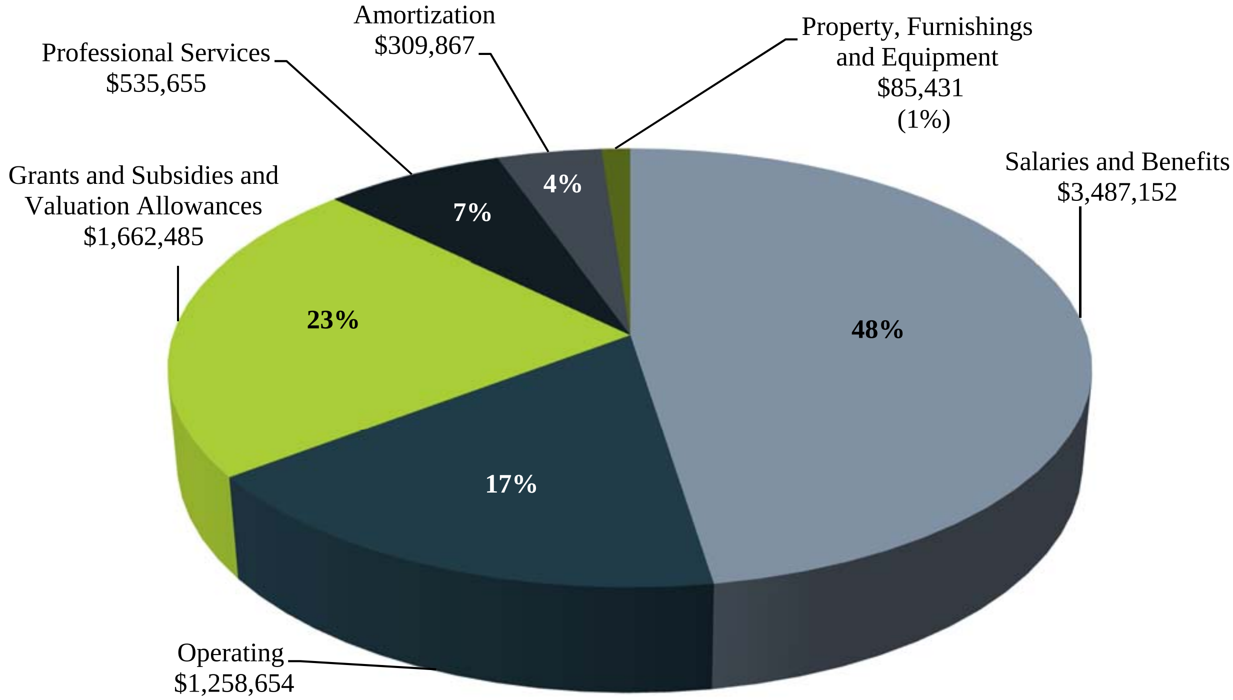


Total: $7,339,244

Source: Public Accounts

As with any organization providing programs and services, the Province spends the majority of its expenses on human resources – its employees. In 2018-19, the Province spent $3.5 billion, on salaries and employee benefits, representing 48.0 per cent of the total program spending.

PROGRAM EXPENSES BY CATEGORY: 2018-19 ($000s)

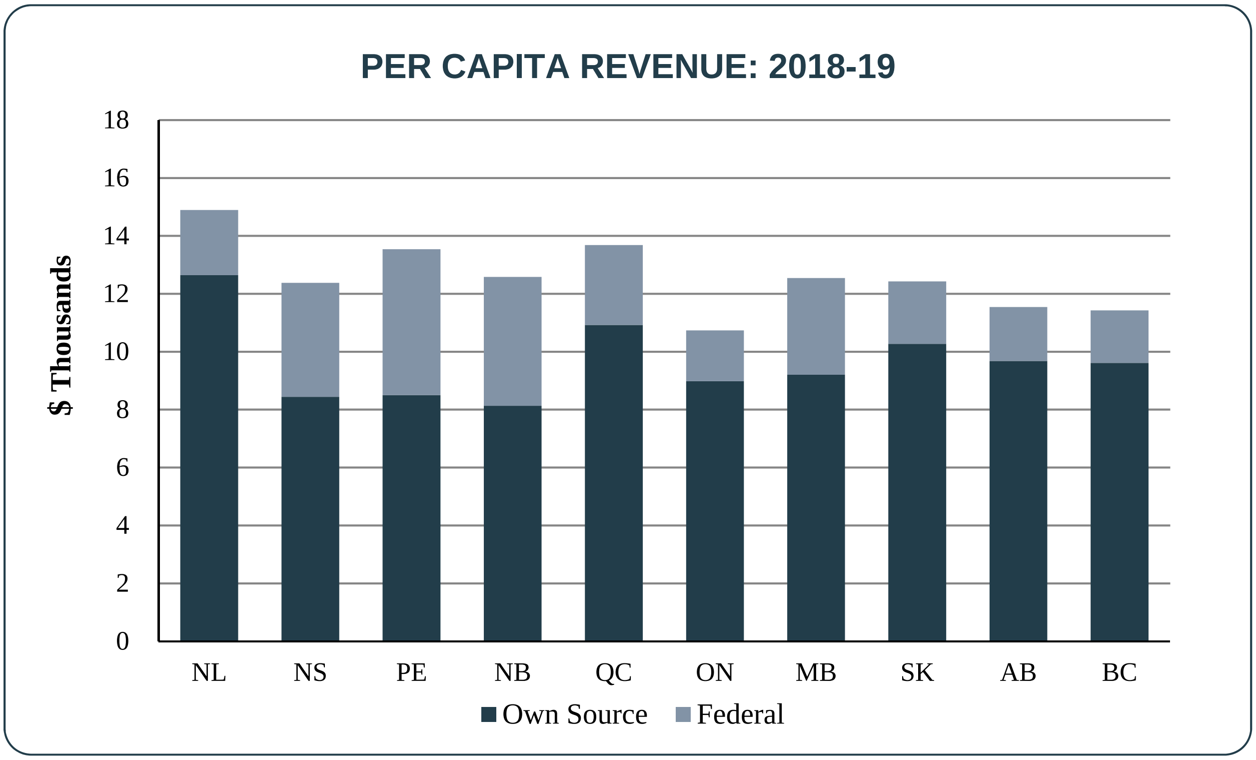


Total: $7,339,244

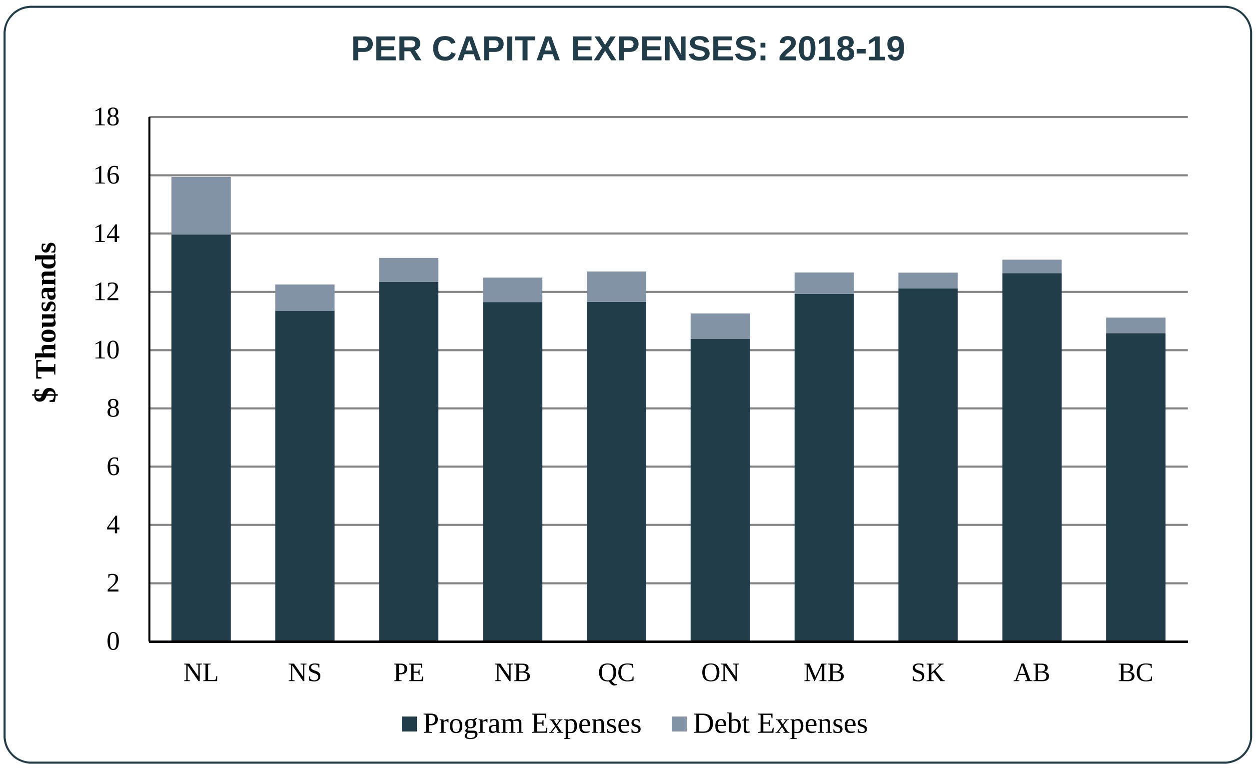
Source: Public Accounts

Revenue and Expenses per Capita

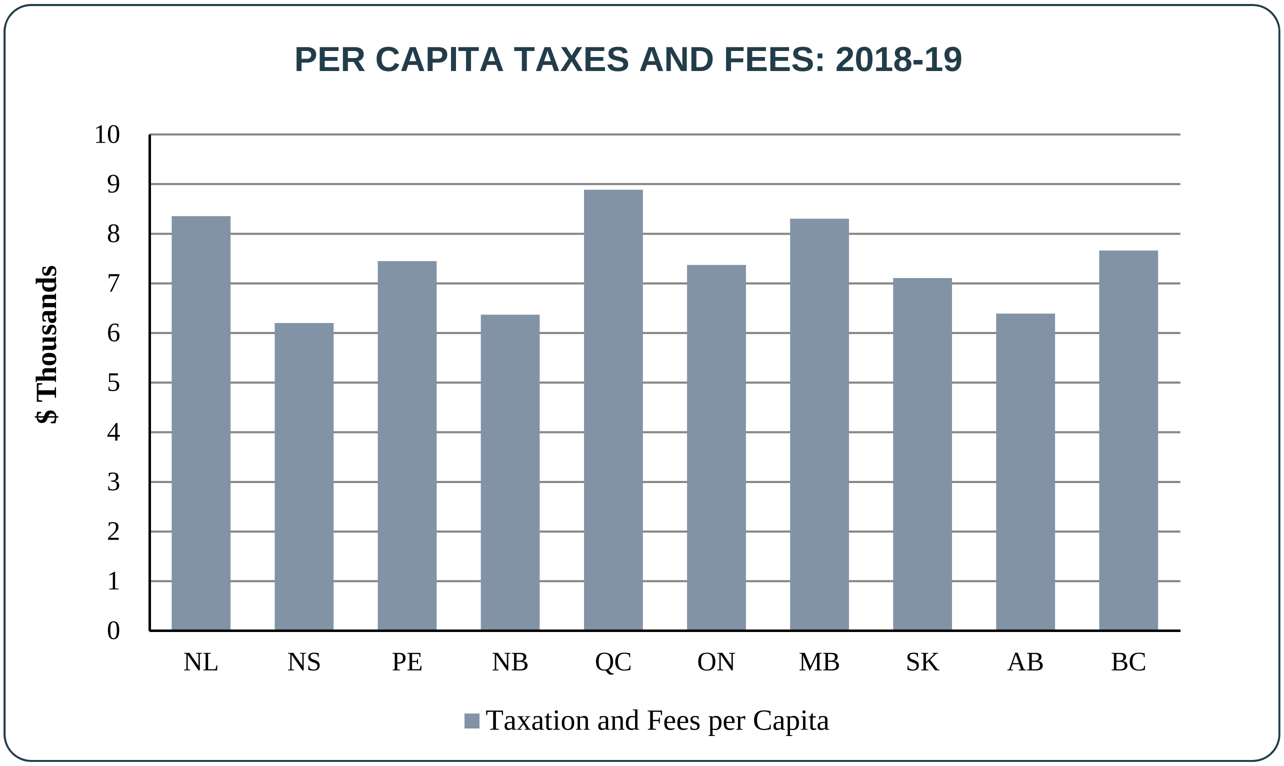
On a per capita basis, Newfoundland and Labrador generates more revenue than every other province. Newfoundland and Labrador also has one of the highest tax burdens on a per capita basis in the country. However, per capita spending in this Province is substantially higher than other provinces. We spend more than every other province by a considerable margin – approximately 21% more per capita than the next highest province – Prince Edward Island, followed by Alberta. We also spend more per capita than our per capita revenues. Overall, this suggests that revenue is not the primary issue creating the deficits but the level of spending. Continued emphasis on sustainably reducing the Province's per capita spending will remain important.



Source: Public Accounts – all provinces (actual); Statistics Canada, Table: 17-10-0005-01, Population estimates on July 1st by age and sex (actual)



Source: Public Accounts – all provinces (actual); Statistics Canada, Table: 17-10-0005-01, Population estimates on July 1st by age and sex (actual)



Source: Public Accounts – all provinces (actual); Statistics Canada, Table: 17-10-0005-01, Population estimates on July 1st by age and sex (actual)

Economic Outlook

Economic forecasts predict how well the economy will perform and provides essential information for Government in developing multi-year plans and annual budgets.

Observations

28. The Province's economic forecast is based on assumptions and future expectations and, like any forecast, is subject to potential upside opportunities but is also subject to downside risks and change.

29. Economic growth is expected to continue in 2020 with increased capital investment and increased exports. The medium-term outlook beyond 2020 is expected to remain challenging due to declining construction activity on major projects and lower Government spending.

30. GDP growth is forecast as modest from 2019 to 2022 based on increases in oil prices and oil and mineral production.

31. Capital investment is expected to decline significantly from 2019 through 2022 as compared to its peak in 2016, which will have a corresponding negative impact on employment, income and revenue to the treasury.

32. Budget 2019 forecasted employment would drop slightly from 225,300 persons in 2018 to 224,900 persons by 2022. This is a decrease of 400 persons over a four-year period and a decrease of 17,800 from the high of 242,700 in 2013. While only one of a number of factors that impact tax revenues, 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.

The Province's economic forecast is based on assumptions and future expectations and, like any forecast, is subject to upside potential opportunities but is also subject to downside risks and change. The Province's 2019 Fiscal and Economic Update indicated that in 2020, economic growth is expected to continue with increased capital investment and increased exports. The medium-term outlook beyond 2020 is expected to remain challenging due to declining construction activity on major projects and lower Government spending.

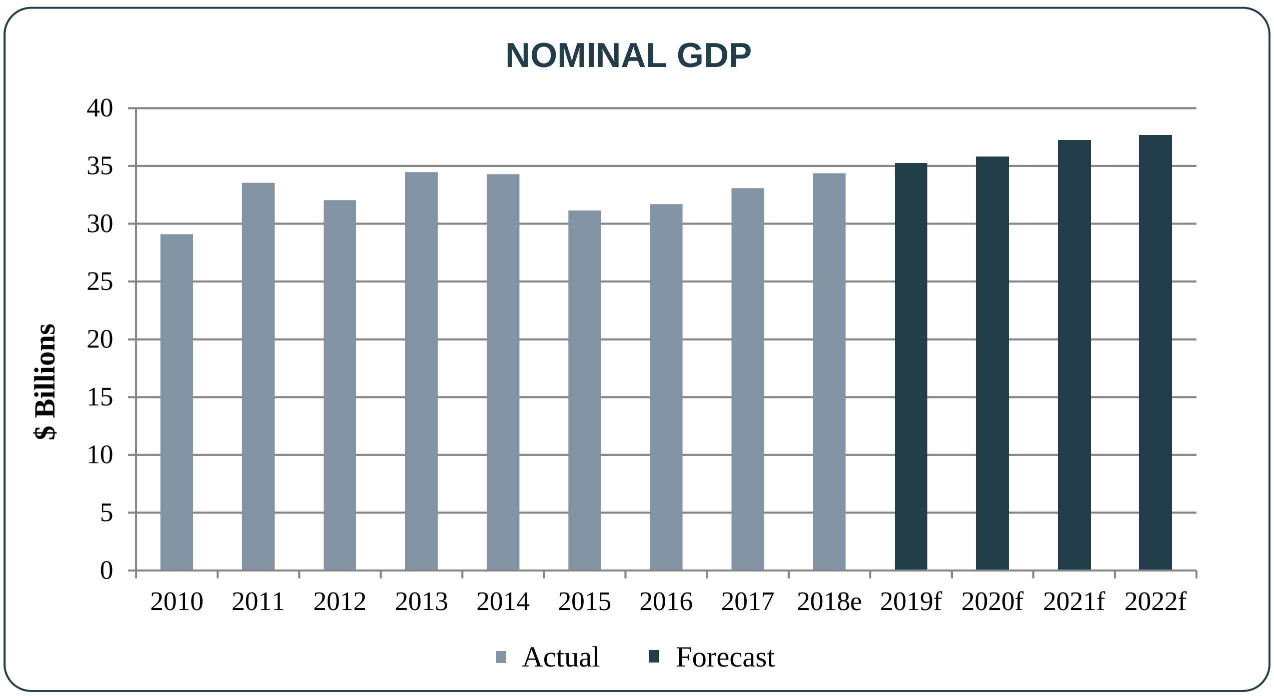
Despite these medium-term challenges, the 2019 Fiscal and Economic Update highlighted opportunities for a more positive long-term outlook including anticipated sanction of the Bay du Nord offshore oil project in 2021 with construction expected to commence in 2022. The Update also highlighted, among other things, the Province's substantial oil and gas resources available for future development and continued strong interest by industry in offshore land sales and exploration.

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, focusing on the volume of activity. 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.

Nominal GDP has experienced considerable fluctuation over the past ten years - most notably in 2015 and 2016, when GDP was impacted by both oil price and oil production declines.

The Province's economic forecast for 2019 to 2022 predicts, in general, modest GDP growth, driven by anticipated increases in oil prices and oil and mineral production.

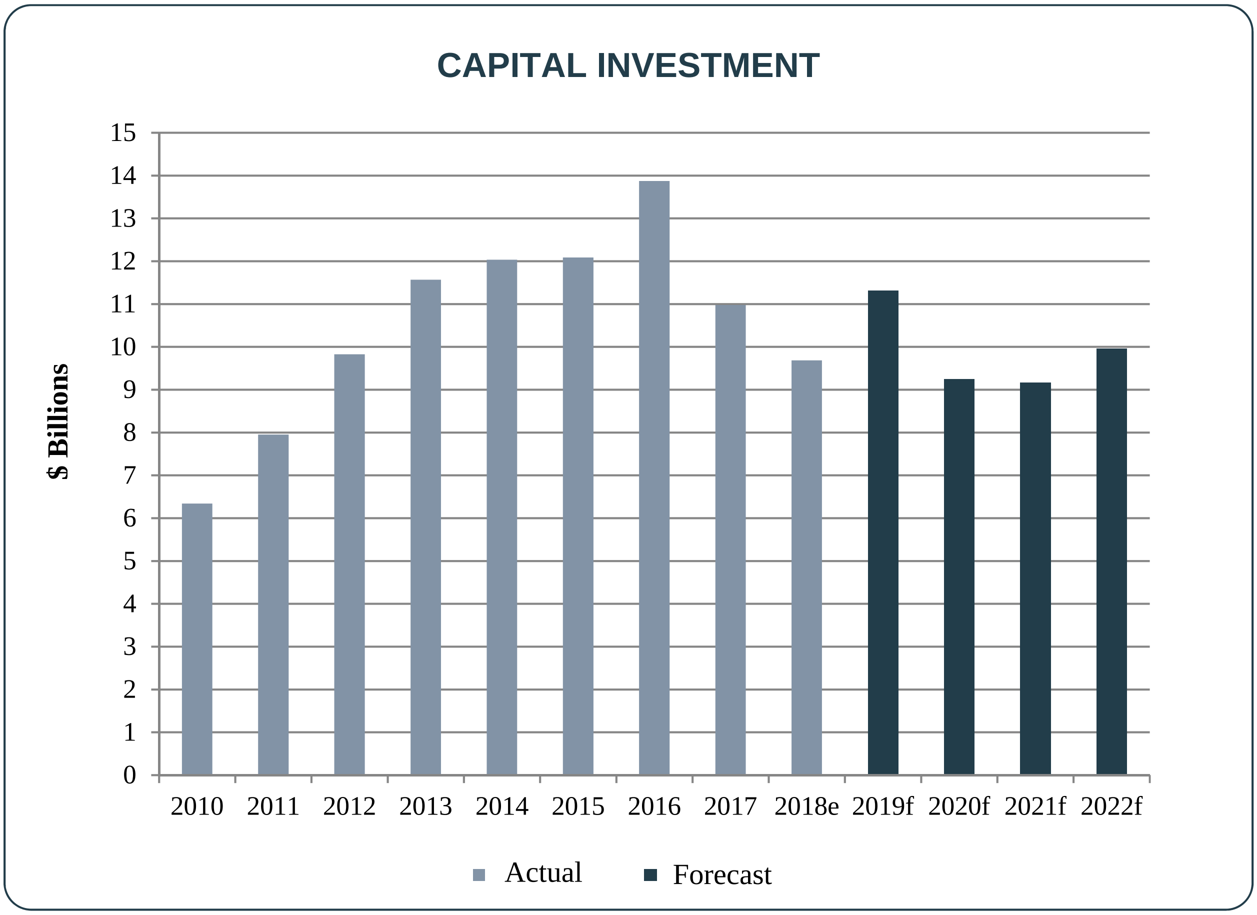


Source: Statistics Canada, Table: 36-10-0222-01, Gross domestic product, expenditure-based, provincial and territorial, annual (x 1,000,000) (actual); Department of Finance (forecast)
Note: Nominal GDP is presented on a calendar year basis.

Much of the increased oil production is expected from the Hebron field. Because of the structure of the royalty regime, it would not be expected that overall royalty revenue from all projects 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 as compared to other projects.

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 the Muskrat Falls project. These projects generate strong levels of employment and considerable benefits throughout the economy and to the treasury during the construction cycle.

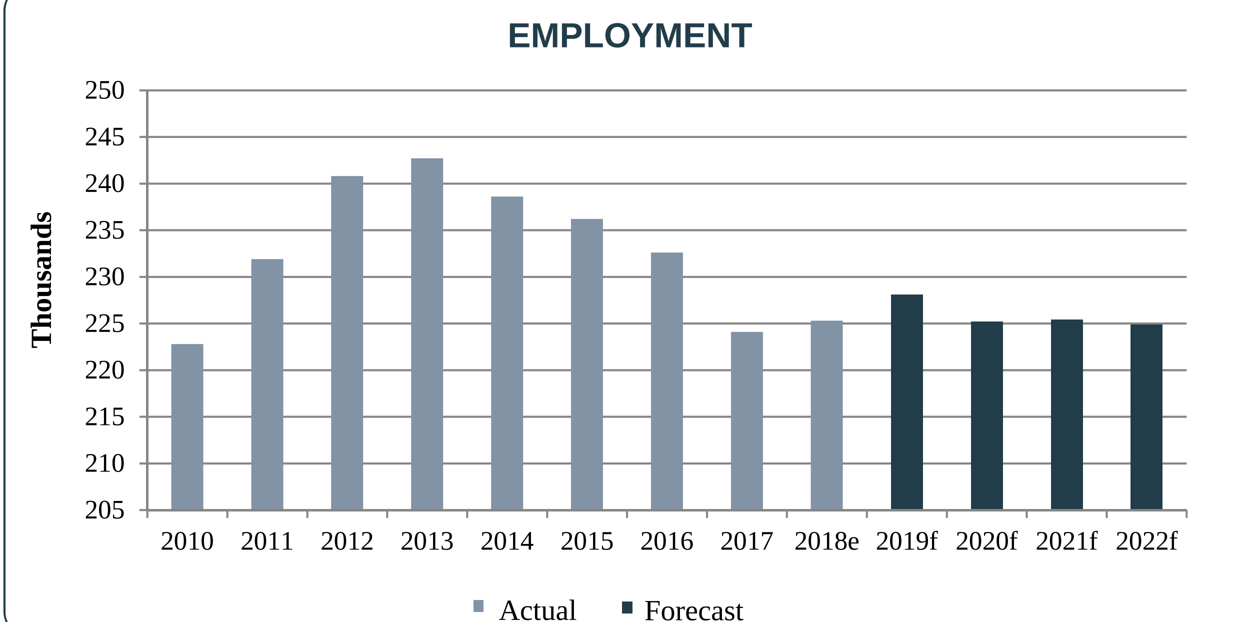


Source: Statistics Canada, Table: 36-10-0222-01, Gross domestic product, expenditure-based, provincial and territorial, annual (x 1,000,000) (actual); Department of Finance (forecast)
Note: Capital investment is presented on a calendar year basis.

The 2019 Fiscal and Economic Update forecasts that capital investment will increase in 2020 from 2019 levels as a result of investment at the West White Rose project, which is expected to offset lower spending on the Muskrat Falls Project as it nears completion. Overall, during the period 2019 through 2022, the Province is forecasting significant overall declines in the level of capital investment compared to its peak of $13.9 billion in 2016. This decline is a result of the conclusion of the construction phases of the Long Harbour, Hebron and Muskrat Falls projects. While only one of a number of factors that impact tax revenues, declines in capital investment will have a corresponding drop in employment and income and will negatively impact revenue to the treasury from tax sources such as personal income tax and consumption taxes such as HST.

Employment

Consistent with the forecasted levels of capital investment, Budget 2019 also forecasted an increase in employment for 2019, followed by a decline in employment levels from 2020 through 2022. Again, while only one of a number of factors that impact tax revenues, this decline 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.



Source: Statistics Canada, Table: 14-10-0327-01, Labour force characteristics by sex and detailed age group, annual (actual); Department of Finance (forecast)
Note: Employment is presented on a calendar year basis.

Budget 2019 forecasted employment would drop from 225,300 persons in 2018 to 224,900 persons by 2022. This is a slight decrease of 400 persons over a four-year period and a decrease of 17,800 from the high of 242,700 in 2013.

Fiscal Outlook: 2019-20 to 2022-23

The 2019 Fiscal and Economic Update provided an update on the expected financial results for 2019-20 but did not provide any further update to the forecasted surpluses and deficits from 2020-21 to 2022-23. Thus, the most recent medium-term surplus and deficit projections discussed in this Chapter were provided in Budget 2019. These mid-term projections are expected to be updated in Budget 2020.

Observations

33. The Province is projecting a surplus of $1.56 billion in 2019-20 driven primarily by the recognition of additional one-time revenue of $2.5 billion from the Hibernia Dividend Backed Annuity Agreement. For 2020-21 and 2021-22, the Province forecasts deficits of $796 million and $300 million respectively, with a return to a small surplus in 2022-23.

Achieving a surplus in 2022-23 reflects the following assumptions over the four year period 2019-20 to 2022-23:

- **generally maintaining the same level of revenue in 2022-23 as 2018-19; and**
- **decreasing program expenses by $570.3 million - 7.77 per cent or an average of 1.94 per cent per year and decreasing debt expenses by $0.7 million.**

34. The Province's fiscal outlook for 2019-20 to 2022-23 is subject to considerable risks which include, but are not limited to, the following:

- **The expected average decline in program expenses of 1.94 per cent per year is less than the expected rate of inflation and would not allow for inflationary or other pressures. Keeping expenses at these forecast levels will be challenging, particularly in the area of health costs with the Province's rapidly aging population.**

- **The fiscal forecast at Budget 2019 included a provision of $200.0 million in dividends from Nalcor for each of the 2020-21 to 2022-23 fiscal years to help address Government's commitment to mitigate electricity rates related to the Muskrat Falls Project. In April 2019, Government released a proposed framework to address the rate mitigation costs, estimated at $725.9 million in 2021. This framework for 2021 includes:**

  - **$525.9 million in combined provincial revenues and cost savings, which includes the $200.0 million Nalcor dividend; and**
  - **$200.0 million in federal contributions which are not yet confirmed or defined.**

In meeting Government's commitment to mitigate electricity rates for the cost of Muskrat Falls, should the above-anticipated sources of funding not be achieved in 2020-21, this will negatively impact the Province's forecasted deficit. Rate mitigation costs beyond 2021 are projected to increase and remain a risk to the Province's fiscal forecast. The report of the Board of Commissioners of Public Utilities to outline options to mitigate electricity rate impacts of Muskrat Falls is expected in January 2020. This report will inform Government's final plan for electricity rate mitigation beyond 2021.

- **The Province will also have to assess the impact of its final rate mitigation strategy on the valuation of the Muskrat Falls Project assets. If the assets are determined to be impaired, the assets would have to be written down to an appropriate value. This potential asset impairment is a risk to the Province's fiscal forecast.**

- **The Province's economic forecast is based on assumptions and future expectations and impacted by global and national economic environments, including trade relations, and so 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.**

- **The forecast includes corporate tax revenues which are subject to volatility as some of the largest remitters are commodity-based and commodity prices and production are factors outside of the Government's control.**

- **The forecast at Budget 2019 included a provision for carbon tax revenues of $20 per tonne commencing January 2019 and increasing to $50 per tonne for light fuel oil (diesel) and $30 per tonne for gasoline by 2022-23, subject to achieving Atlantic parity. However, to ensure regional competitiveness, the carbon tax rate on gasoline and light fuel oil (diesel) will only increase beyond 2019 if carbon pricing in the other three Atlantic Provinces allows for such increases. This introduces risk that the Budget 2019 forecasted revenues from carbon tax may not materialize.**

- **The forecast includes an increase in oil royalties based on an assumption of increasing oil prices and oil production to 2022-23 – factors outside the Province's control.**

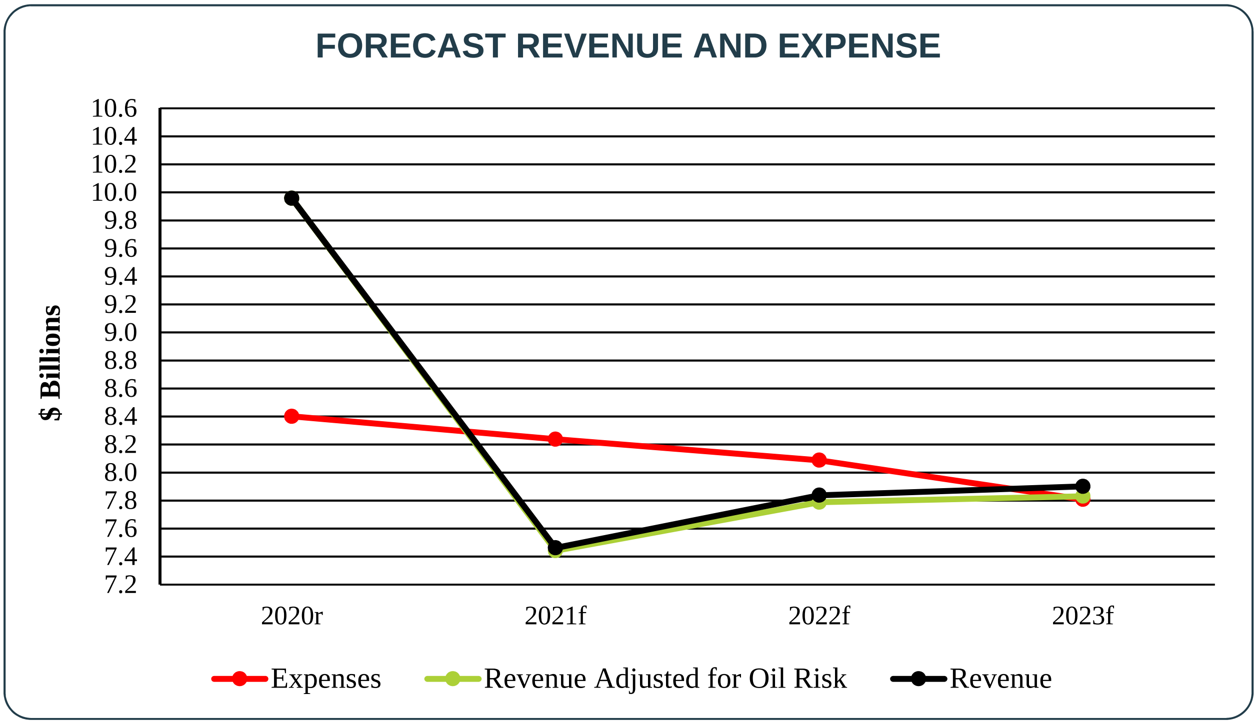
35. While there is a potential upside for economic performance to be stronger than forecast and opportunities for increased revenues, should the downside risks to the forecast materialize and result in significantly less revenues than expected or more expenses than expected, Government would be significantly challenged to address such a shortfall and remain on target to return to surplus in 2022-23. There is limited flexibility, for example, to address such a shortfall with increased taxes as the Province currently has one of the highest tax burdens on a per capita basis in the country. Further, current borrowing levels are significant and any additional borrowings would further increase the debt expense burden which is currently forecast to average 12.5 per cent of total revenues during 2019-20 to 2022-23.

The Province is forecasting the following fiscal outlook over the four-year period 2019-20 to 2022-23:

- a surplus of $1.56 billion in 2019-20 largely driven by the recognition of additional one-time revenue of $2.5 billion from the Hibernia Dividend Backed Annuity Agreement;
- deficits for the following two-year period of $796 million in 2020-21 and $300 million in 2021-22; and
- return to a small surplus in 2022-23.

Achieving a surplus in 2022-23 reflects the following assumptions over the four year period 2019-20 to 2022-23:

- generally maintaining the same level of revenue in 2022-23 as 2018-19; and
- decreasing program expenses by $570.3 million - 7.77 per cent or an average of 1.94 per cent per year and decreasing debt expenses by $0.7 million.

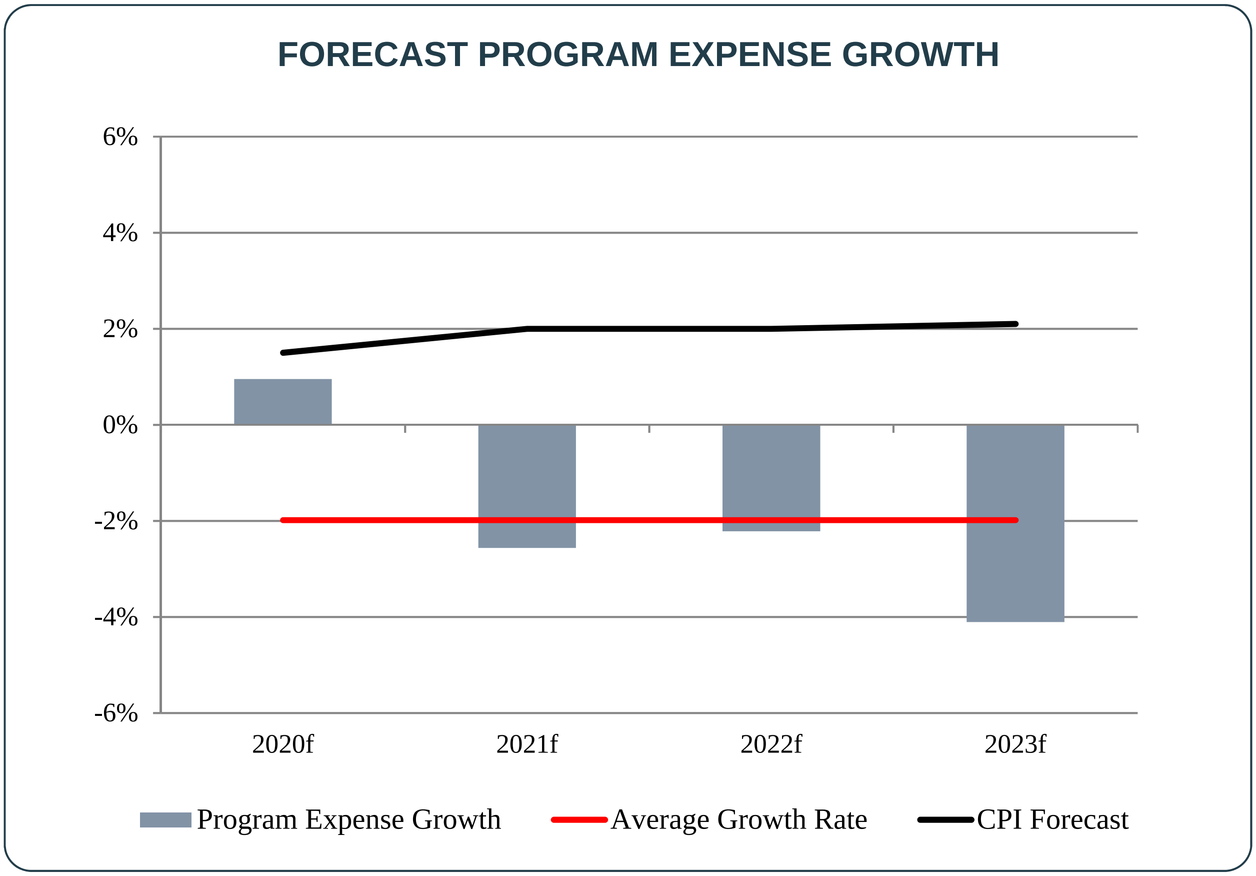


Source: Department of Finance (Budget 2019); 2019 Fiscal and Economic Update

There are a number of risks associated with the expense forecast which include, but are not limited to, the following:

Forecast Decline in Program Expenses

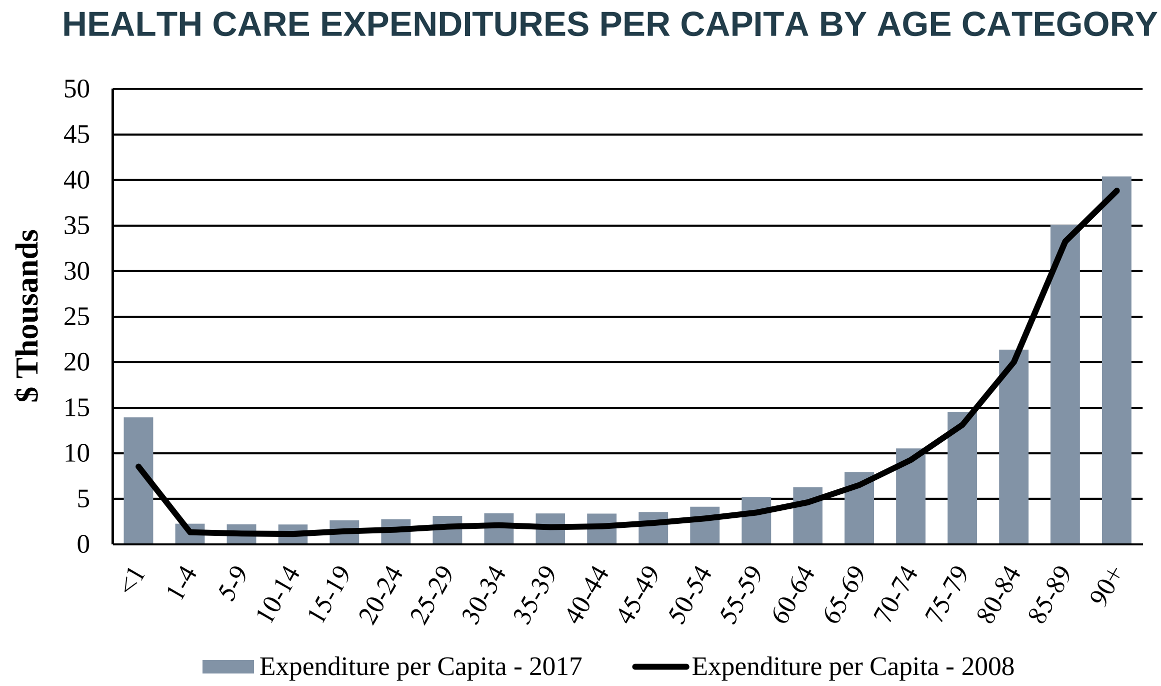
The forecast expects an average decline in program expenses from 2019-20 to 2022-23 of $570.3 million - 7.77 per cent or an average of 1.94 per cent per year, which is less than the Province's expected CPI growth over the same period. Therefore, the forecasted decline in program expenses would not allow for inflationary or other pressures.



Source: Department of Finance (Budget 2019)

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.

One key pressure on expenditures stems from the Province's rapidly aging population. This demographic challenge has cost implications on programs and services. Health care costs, in particular, increase with age, with significantly higher costs later in life. Approximately 21.5 per cent of the Province's population is age 65 and older and this is expected to increase to 28.3 per cent by 2029.



Source: National Health Expenditure Database, Canadian Institute for Health Information

Electricity Rate Mitigation for the Muskrat Falls Project

Another key risk on constraining expenses pertains to the overall costs of the Muskrat Falls project and how it will ultimately impact ratepayers and Government expenses. The Project is currently expected to cost $12.7 billion, including interest during construction/pre-funded financing and other costs of $2.6 billion. This represents an increase of $5.3 billion from the expected cost when it was sanctioned. As of September 30, 2019, Nalcor Energy and/or its subsidiaries had spent $11.0 billion related to the Project and had contractual commitments to spend a further $0.2 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 under the Inter-Governmental Agreement 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 partnership interest in the Labrador-Island Link. The Province has also committed to fund all additional equity that may be required to cover any further cost overruns on each aspect of the Project. Any further cost overruns may require additional borrowings by the Province which will in turn increase the planned level of debt expenses.

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 were exempted from review by the Board of Commissioners of Public Utilities (PUB).

The fiscal forecast at Budget 2019 included a provision of $200.0 million in dividends from Nalcor for each of the 2020-21 to 2022-23 fiscal years to help address Government's commitment to mitigate electricity rates related to the Muskrat Falls Project. In April 2019, Government released a proposed framework to address the rate mitigation costs, estimated at $725.9 million in 2021. This framework for 2021 includes:

- $525.9 million in combined provincial revenues and cost savings, which includes the $200.0 million Nalcor dividend; and
- $200.0 million in federal contributions which are not yet confirmed or defined.

In meeting Government's commitment to mitigate electricity rates for the cost of Muskrat Falls, should the above-anticipated sources of funding not be achieved in 2020-21, this will negatively impact the Province's forecasted deficit. Rate mitigation costs beyond 2021 are projected to increase and remain a risk to the Province's fiscal forecast. The final report of the PUB to outline options to mitigate electricity rate impacts of Muskrat Falls is expected to be provided to Government for consideration in January 2020. This report will inform Government's final plan for electricity rate mitigation beyond 2021.

Monitoring the Province's Investment in Nalcor

Under Canadian 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 ratepayers.

Because of the self-sustaining nature of GBEs, they are considered investments and therefore, under Canadian Public Sector Accounting Standards, their assets and liabilities are not combined with the assets and liabilities of other government entities. Rather, the net of the GBEs assets less liabilities is recorded in one line as equity in GBE on the Province's Consolidated Statement of Financial Position. In essence, the debt of a GBE is not explicitly shown on the Province's Consolidated Statement of Financial Position as any debt is offset by the assets which generate 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.

As noted above, 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. This existing structure supported the current valuation of the Muskrat Falls assets at March 31, 2019.

In its Financial Statement Discussion and Analysis report for the year ended March 31, 2019, Government included commentary on risks to the Province's financial position and forecast which included risks relating to Government's rate mitigation strategy for the Muskrat Falls project.

Mitigation of electricity rates may have an impact on the valuation of the Muskrat Falls Project assets on the financial statements of Nalcor and possibly the valuation of the Province's investment in Nalcor on the Consolidated Summary Financial Statements. Therefore, we consider the valuation of the Province's investment in Nalcor to be a significant risk and we perform additional audit procedures to address this risk.

We included an Other Matter paragraph in our Independent Auditor's Report on the Consolidated Summary Financial Statements for the year ended March 31, 2019 to highlight that, while Government has not yet finalized specific strategies for its rate mitigation plan, implementation of this plan may have a significant impact on the Province's Consolidated Summary Financial Statements in future years. We further noted that we did not modify our audit opinion on the Province's Consolidated Summary Financial Statements because of this matter.

The Province will have to assess the impact of its final rate mitigation strategy on the Consolidated Summary Financial Statements, in particular the valuation of the Muskrat Falls Project assets and Nalcor's status as a GBE. If Nalcor were to no longer meet the criteria of a GBE, its assets and liabilities would have to be combined with the assets and liabilities of other Government entities. If the assets are determined to be impaired, the asset would be written down to an appropriate value. These scenarios, if realized, would have an impact on the Province's Consolidated Summary Financial Statements.

Our Office will continue to closely monitor this matter.

Forecast Revenue Growth

To achieve the planned surplus in 2022-23, the Province will generally have to maintain the same level of revenue in 2023 as 2019. The forecast indicates increases in all categories of own source revenues, including taxation revenues and offshore royalties. There are a number of risks associated with the revenue forecast which include, but are not limited to, the following:

- The Province's economic forecast is based on assumptions and future expectations and impacted by global and national economic environments, including trade relations, and so, 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.

- The forecast for corporate tax revenues is subject to volatility as some of the largest remitters are commodity-based and commodity prices and production are factors outside the Government's control. Further, taxes paid by these companies in this Province are often based on inter-jurisdictional taxable income and thus is impacted by a company's operating results in other jurisdictions. For example, expected increases in taxes in our Province from an offshore oil company could be reduced if the company incurs losses in other Canadian jurisdictions.

- The forecast at Budget 2019 included a provision for carbon tax revenues of $20 per tonne commencing January 2019 and increasing to $50 per tonne for light fuel oil (diesel) and $30 per tonne for gasoline by 2022-23, subject to achieving Atlantic parity. However, to ensure regional competitiveness, the carbon tax rate on gasoline and light fuel oil (diesel) will only increase beyond 2019 if carbon pricing in the other three Atlantic Provinces allows for such increases. This introduces risk that the Budget 2019 forecasted revenues from carbon tax may not materialize.

- The forecasted increase in oil royalties is based on an assumption of increasing oil prices and oil production to 2022-23 - factors outside of the Province's control. A stronger Canadian dollar than forecasted would also negatively impact oil royalties.

Overall Risk to Forecast

While there is a potential upside for economic performance to be stronger than forecast and opportunities for increased revenues, should the downside risks to the forecast materialize and result in significantly less revenues than expected or more expenses than expected, Government would be significantly challenged to address such a shortfall and remain on target to return to surplus. There is limited flexibility, for example, to address such a shortfall with increased taxes as the Province currently has one of the highest tax burdens on a per capita basis in the country. Further, current borrowing levels are significant and any additional borrowings would further increase the debt expense burden which is currently forecast to average 12.5 per cent of total revenues during 2019-20 to 2022-23.

Credit Ratings

Bond rating agencies provide an independent assessment of the Province's credit worthiness based upon their own assessment of the Province's fiscal situation. If the Province were not to achieve the targets it has established in its forecast (i.e. its fiscal plan), there could be further negative pressure on the Province's credit ratings. The higher interest rates associated with lower credit ratings would increase the Province's cost of borrowing and may impair its access to capital markets, restricting the Province's ability to borrow.

The Province receives credit ratings from three firms: Moody's Investors Service (Moody's), Standard & Poor's Ratings Services (S&P), and Dominion Bond Ratings Services (DBRS).

During 2019, Moody's downgraded the Province's rating from Aa3 Negative to A1 Stable citing factors including the Province's large debt level, weak financial metrics of Nalcor, high interest expense and volatility of revenues relative to other provinces, and the expectation it would continue to post deficits.

S&P confirmed their rating as A Stable citing factors such as continued expenditure management and benefits from Canada's provincial-federal institutional framework, including the renewal of the Atlantic Accord Agreement.

DBRS also confirmed their rating as A (low) Stable. DBRS noted that, while the fiscal and economic outlook remains challenging, Government's efforts have significantly reduced annual budget deficits and slowed the pace of debt growth.

Bond Rating Agency	Long-Term Rating	Short-Term Rating	Outlook	Date of Rating
S&P	A	A-1	Stable	August 8, 2019
Moody's	A1	Not rated	Stable	July 24, 2019
DBRS	A (low)	R-1 (low)	Stable	September 26, 2019

CHAPTER 4

UNDERSTANDING THE CONSOLIDATED SUMMARY FINANCIAL STATEMENTS

While the annual Budget outlines Government's fiscal forecast or plan for the year, the Consolidated Summary Financial Statements are the financial report card of the actual results for the fiscal year – from April 1 to March 31. 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 an overview of changes in Government's financial position and highlight key figures and comparative information from previous years.

This chapter provides an overview of the five financial statements that comprise the Consolidated Summary Financial Statements. These statements are each designed to provide separate important pieces of information that link together to present a complete and comprehensive picture of the Province's financial position and its operations for the fiscal year. These five statements include:

- Consolidated Statement of Financial Position
- Consolidated Statement of Change in Net Debt
- Consolidated Statement of Operations
- Consolidated Statement of Change in Accumulated Deficit
- Consolidated Statement of Cash Flows

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

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, 2019). Comparative figures are also shown for the same point in time for the previous year. This allows the reader to be able to make comparisons and consider trends related to financial results.

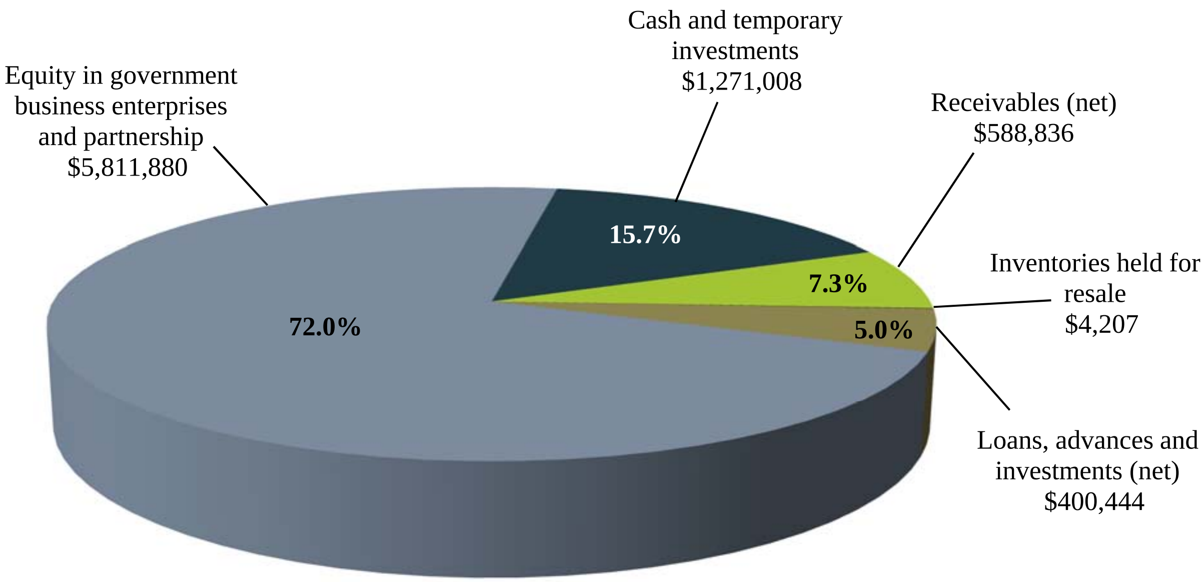
Five main components make up the financial position of the Province at March 31, 2019:

Component	Amount at March 31, 2019 (000s)
Financial Assets	$ 8,076,375
Liabilities	23,450,346
Net Debt	**15,373,971**
Non-financial Assets	4,610,337
Accumulated Deficit	**$ 10,763,634**

Financial Assets

Financial assets are assets that can be used to discharge existing liabilities or finance future operations.

FINANCIAL ASSETS: 2018-19 ($000s)

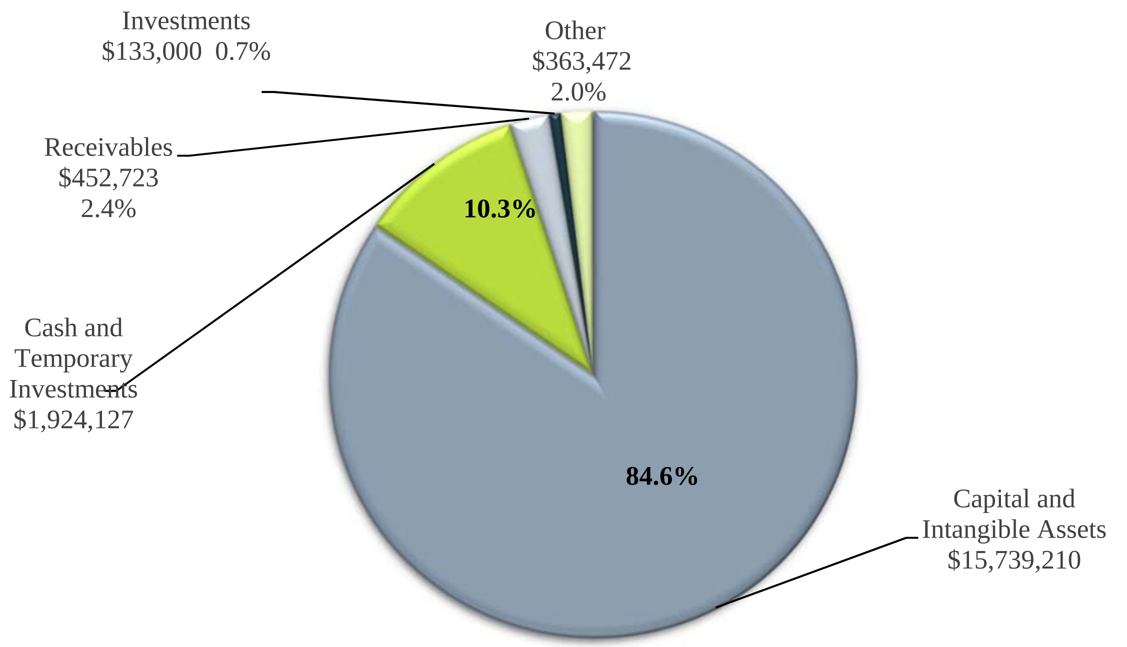


Total: $8,076,375

Equity in Government Business Enterprises (GBEs) and Government Business Partnership (GBP) reflects the net assets (assets less liabilities) of Nalcor Energy, the Newfoundland and Labrador Liquor Corporation, and Government's 25 per cent 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.

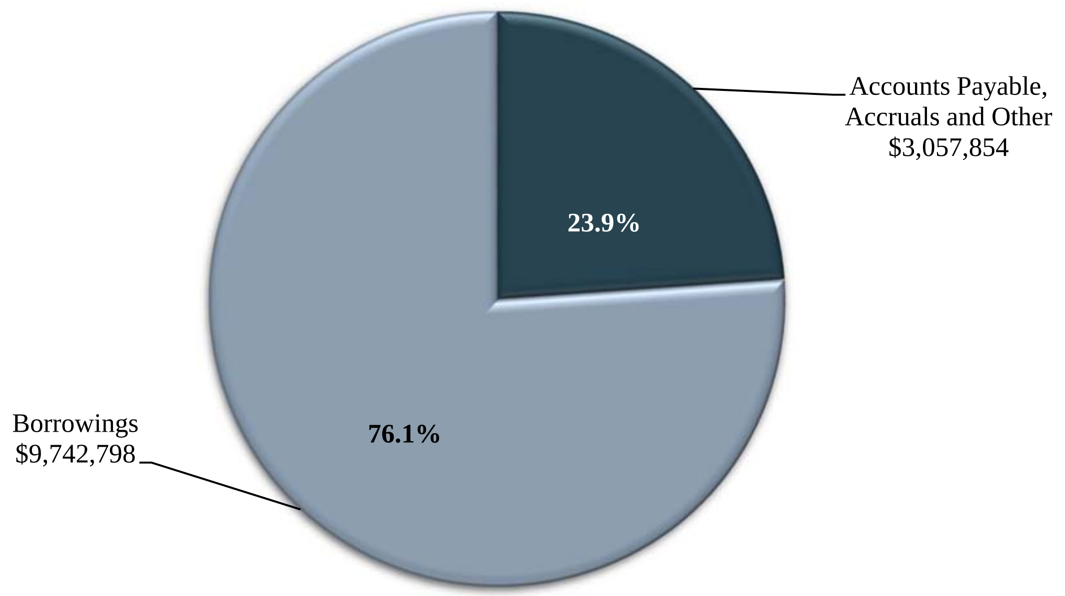
At March 31, 2019, equity in GBEs/GBP represents approximately 72 per cent of Province's consolidated financial assets. The net equity of the GBEs/GBP of $5.8 billion is comprised of assets of $18.6 billion less liabilities of $12.8 billion.

GBE/GBP's ASSETS: 2018-19 ($000s)



Total: $18,612,532

GBE/GBP's LIABILITIES: 2018-19 ($000s)

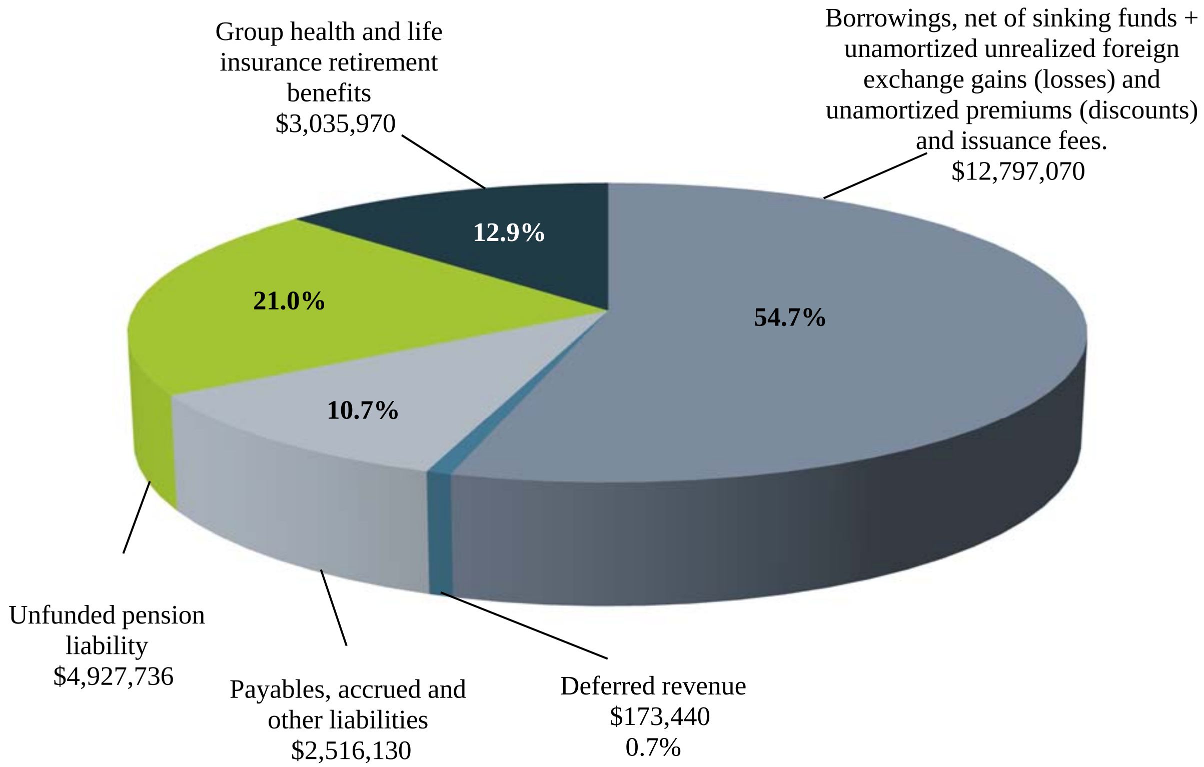


Total: $12,800,652

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.

LIABILITIES: 2018-19 ($000s)



Total: $23,450,346

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, 2019, was $15.4 billion (2018 - $14.7 billion).

Non-financial Assets

Non-financial assets are assets consumed in the delivery of government services but not intended to reduce existing or future liabilities. The most significant non-financial assets are the Province's investment in tangible capital assets, which comprise such things as land, buildings, roads, equipment, vehicles and other items that have a useful life extending beyond one year.

Non-financial assets of the Province at March 31, 2019, were $4.6 billion (2018 - $4.5 billion). This balance was comprised of tangible capital assets of $4.5 billion and prepaid expenses, deferred charges and inventories of $0.1 billion.

Accumulated Deficit

This is the accumulated amount of deficits that the Province has incurred over time, less any surpluses.

The accumulated deficit at March 31, 2019, was $10.8 billion (2018 - $10.2 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:

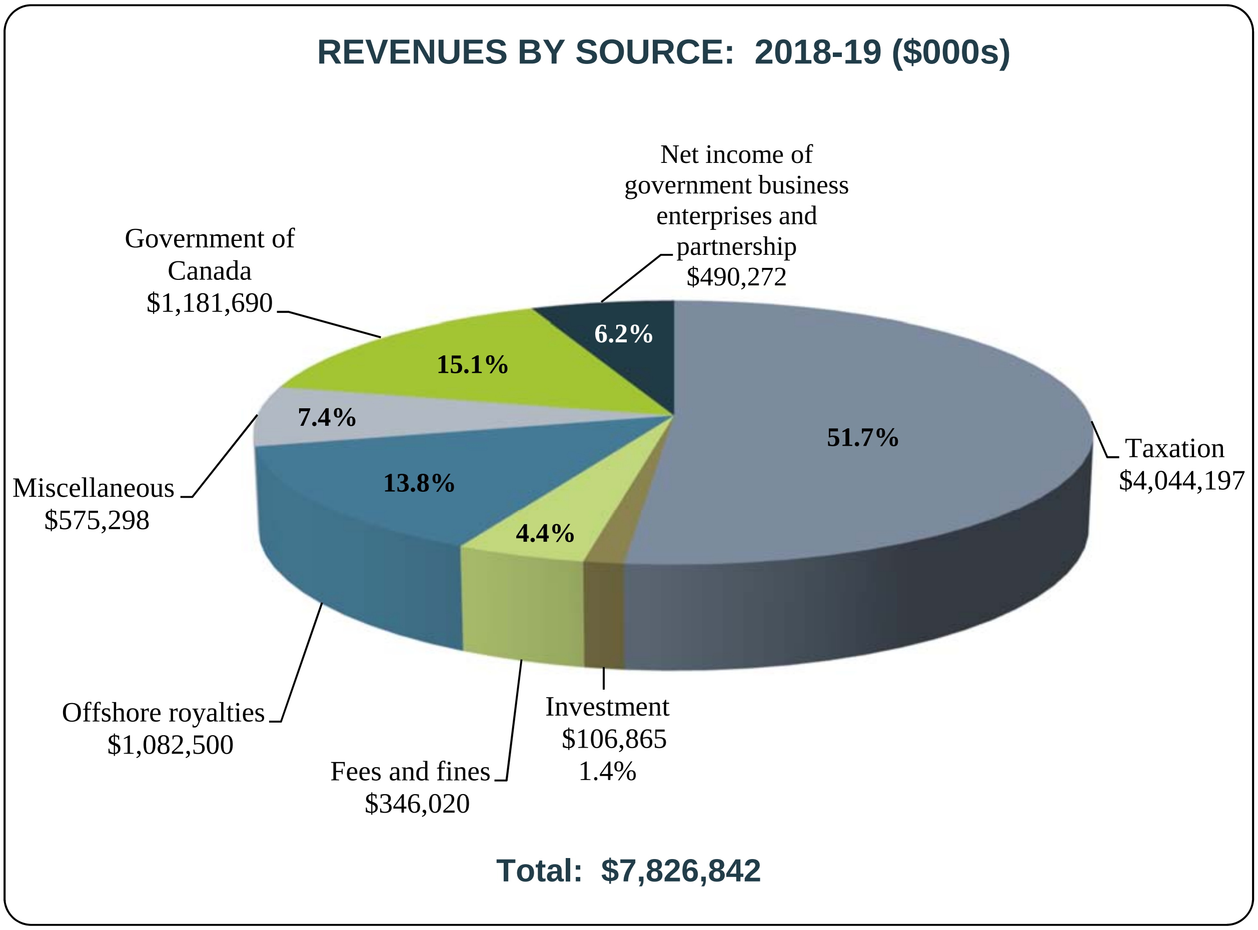
1. Surplus or deficit for the year - If the Province operates with a surplus for the year, this will reduce Net Debt. Similarly, a deficit will increase Net Debt.

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

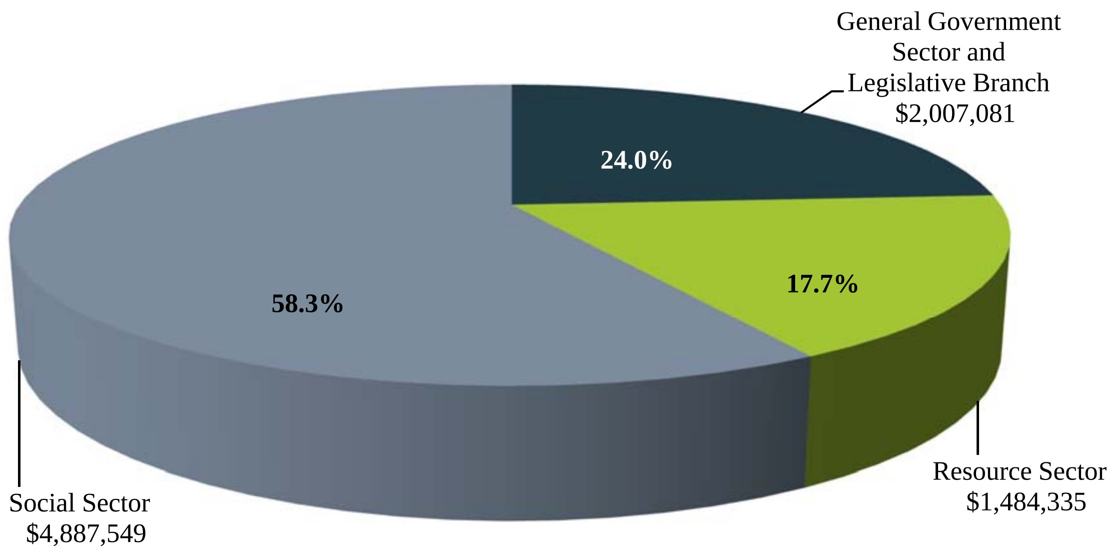
This statement shows the consolidated results of the operations of the Government Reporting Entity for the year April 1, 2018 to March 31, 2019. These results are compared to the original estimates that were presented to the Legislature and approved as part of the budget process.

The statement provides the amount of revenues that the Province generated during the year and is broken down by major categories.



The statement also provides information on the expenses incurred by the Province during the year by major functional area.

EXPENSES BY MAJOR FUNCTIONAL AREA: 2018-19 ($000s)



Total: $8,378,965

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

The Province recorded a deficit of $0.55 billion for the year ended March 31, 2019 (2018 - $0.9 billion deficit).

Consolidated Statement of Change in Accumulated Deficit

This statement provides the details of what comprises the change in accumulated deficit for the year. The main element impacting the accumulated deficit is the annual surplus or deficit.

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

CHAPTER 5

OTHER MATTERS

Opportunities for Improvements Identified

Audits of financial statements of the Province and other Government entities are directed primarily to expressing an opinion on the financial statements and are not designed to express an opinion as to whether the systems of controls established by management have been properly designed or have been operating effectively. However, each year during these audits, matters may come to the auditors' attention for which the auditor identifies recommendations to improve internal controls, financial statement preparation or financial reporting.

Audit of the Consolidated Summary Financial Statements

During the audit of the Consolidated Summary Financial Statements for the year ended March 31, 2019, our Office identified and communicated the following recommendations to Government:

Compliance with Canadian Public Sector Accounting Standards

Government does not record a liability and expense for accumulating non-vesting sick leave benefits for employees in Government departments using actuarial valuations as required by Canadian Public Sector Accounting Standards. The liability and expense for these sick leave benefits is determined by using management's best estimate of the probability of the employees utilizing 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.

A review of the methodology to estimate these revenues may provide opportunities to improve reliability of the estimates and reduce the likelihood of significant adjustments.

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.

We have identified an entity that should be considered for inclusion in the Government Reporting Entity and have requested the Office of the Comptroller General to complete an assessment to determine whether control exists. Also, certain entities which are presently included in the Government Reporting Entity indicate they should not be included as they do not consider themselves to be controlled, either directly or indirectly, by Government.

The Office of the Comptroller General has commenced a comprehensive review of entities both included and excluded from the Government Reporting Entity to ensure accuracy and completeness of the Government Reporting Entity. We encourage the Office of the Comptroller General to continue with this comprehensive 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, in these instances, it may be difficult to compare actual results to planned results.

Allowance for Doubtful Accounts

As part of maintaining an effective financial management system, the accounting policies established to monitor and guide management decisions should be based on consistent principles that are reviewed periodically to determine if the rationale being used is still valid. We examined the allowances for doubtful accounts for various categories of accounts receivable during our audit and noted that one department calculates its allowance for doubtful accounts using a methodology that was developed in 2006. The department was unable to provide any support showing that the rationale being used was still reasonable, such as analysis of recent or historical data on collection rates.

Liability for Contaminated Sites

Contaminated sites which are Government's responsibility to manage, either through direct ownership or due to abandonment, and require remediation are required to be recognized on the financial statements as a liability. The value of the liability is based on the estimated costs to remediate the sites. As at March 31, 2019, the Province had identified approximately 200 sites which may have a related liability for either assessment, remediation, or monitoring. As at March 31, 2019, the Province had recorded a liability related to expenditures that are expected to be incurred for 24 of these 200 sites.

When the Government developed its contaminated sites assessment implementation plan in 2015, it indicated that further policies and procedures would be developed to guide the updates of existing liabilities and for the evaluation of new liabilities. These policies and procedures have not been developed.

During our audit, we noted that underlying information used to determine the estimated liabilities for certain sites has not been updated in recent years and thus is now several years old. Furthermore, additional work is also required for certain sites to further refine the estimated remediation costs. The lack of regular updates for both site assessments and related policies and procedures for completing assessments, increases the risk that estimated liabilities for sites may be inaccurate as they do not reflect the current conditions of sites or related costs of remediation.

Audit of Financial Statements of Crown Entities

The Consolidated Summary Financial Statements include the financial activities of Government departments and the Legislature (Consolidated Revenue Fund) as well as 43 other Crown entities. A listing of these entities is included in Appendix I. In addition to the audit of the Consolidated Revenue Fund, our Office audits the financial statements of 18 of these 43 Crown entities as well as the Province of Newfoundland and Labrador Pooled Pension Fund and the Newfoundland and Labrador Government Sinking Fund. Private sector auditors perform audits of the financial statements for 23 of the 43 Crown entities (outlined in Appendix I). Audits of two Crown entities were not completed during 2018-19 as the entities were not material to the Government Reporting Entity or were inactive during the year.

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 Consolidated Summary Financial Statements, 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 of interest to the House of Assembly.

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

Number of issues	Number of entities audited by the Office of the Auditor General	Number of entities audited by private sector auditors
No issues	11	16
1 to 4 issues	8	5
5 or more issues	1	2
Total	**20**	**23**

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

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	2	5
Maintenance of accounting records	4	4
Financial statement preparation	3	1
Other	6	1

Internal controls

Issues that were identified related to internal controls included:

- absence of an audit committee;
- absence of a formal risk assessment process;
- bank reconciliations not approved or not approved on a timely basis;
- lack of segregation of duties;
- delays in the preparation of journal entries;
- absence of an internal audit function;
- deficiencies related to controls over payroll; 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.

Maintenance of accounting records

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

- accounts and/or sub ledgers not being reconciled on a timely basis;
- errors in inventory balance;
- the need for an entity to use a system to account for its tangible capital assets; and
- Harmonized Sales Tax not being recorded correctly.

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.

Financial statement preparation

Issues that were identified related to financial statement preparation included:

- inappropriate application of accounting policies; and
- delay in preparing year-end financial information.

Accounting policies should be applied appropriately to ensure consistent accounting for transactions and to provide users of the entity's financial statements with financial information that is comparable with other entities in the Public Sector. Financial statements and supporting details should be prepared on a timely basis.

Other

Other issues identified included:

- non-compliance with the Financial Administration Act;
- inconsistent compensation practices;
- operating under the terms of an expired contract; and
- use of outdated pay scales.

Crown entities should comply with legislation. Crown entities should also follow the compensation practices specified by Government. Furthermore, Crown entities should ensure that they maintain current contracts with their employees and suppliers. The absence of current contracts that clearly and comprehensively define the risks and obligations of each party may increase financial and performance risk for the entities.

Timing of Release of Consolidated Summary Financial Statements

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 2013, 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 generally been available approximately six months after the year end.

Year End	Audit Report Date	Number of Days After Year-end
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
March 31, 2018	October 4, 2018	187
March 31, 2019	October 18, 2019	201

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; however, Newfoundland and Labrador remains one of the jurisdictions with the latest audit report dates each year.

Jurisdiction	Audit Report Date	
	March 31, 2019	March 31, 2018
Newfoundland and Labrador	October 18, 2019	October 4, 2018
Nova Scotia	July 18, 2019	July 19, 2018
Prince Edward Island	October 25, 2019	October 25, 2018
New Brunswick	September 12, 2019	August 13, 2018
Quebec	October 10, 2019	September 28, 2018 and November 22, 2018
Ontario	August 16, 2019	September 12, 2018
Manitoba	September 23, 2019	September 21, 2018

Jurisdiction	Audit Report Date	
	March 31, 2019	March 31, 2018
Saskatchewan	June 19, 2019	June 29, 2018
Alberta	June 18, 2019	June 19, 2018
British Columbia	June 28, 2019	August 22, 2018
Canada	September 4, 2019	September 12, 2018

Source: Public Accounts – all provinces and Canada

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 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.

Reports Issued Pursuant to Section 15(1) of the Auditor General Act

Section 15(1) of the Auditor General 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 Auditor General Act requires the report be made through the Minister of Finance. In addition, Section 15(2) of this 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, 2019, my Office became aware of matters addressed under Section 15(1) of the Auditor General Act. I reported the following matters to the Minister of Finance on December 13, 2019:

- The Professional Services and Internal Audit Division (PSIA) of the Department of Finance reported the following:

    - The Government Accounting Division of the Department of Finance notified PSIA of multiple instances of cheque fraud against Government. In some instances, individuals attempted to deposit cheques from the Department of Advanced Education, Skills and Labour's Income Support Program more than once using mobile cheque deposit technology. In other cases, cheque stock was forged and attempts were made to cash these falsified cheques. In all these cases, there was no loss to Government due to controls in Government's financial system effectively detecting these cases. These instances were reported to the police for investigation.

    - In February 2019, the Public Engagement and Planning Division of Executive Council informed PSIA of a suspected fraud by an employee of an organization funded by Government. This has been elaborated on in further detail in the information provided directly from Executive Council below.

    - In March 2019, PSIA was asked to investigate a potential fraud by an employee of the Department of Health and Community Services relating to a program administered by the Department. This matter was also reported to my Office and I reported the matter to the Minister of Finance on May 8, 2019.

    - In May 2019, the Department of Fisheries and Land Resources informed PSIA of a break-in to a small storage building at an Agriculture Center whereby equipment was stolen. This incident was reported to the police for investigation.

- In May 2019, the Department of Municipal Affairs and Environment requested that PSIA complete a special review of a funding recipient that was issued grants from the Community Enhancement Employment Program. This has been elaborated on in further detail in the information provided directly from the Department of Municipal Affairs and Environment below.

- In July 2019, the Department of Transportation and Works informed PSIA of fraudulent activity relating to the use of a Government owned building whereby the building was used to store personal property. This has been elaborated on in further detail in the information provided directly from the Department of Transportation and Works below.

- In July 2019, PSIA was informed of three instances of alleged, suspected or actual fraud between the period of November 2018 and June 2019 within the Department of Service NL. These have been elaborated on in further detail in the information provided directly from the Department of Service NL below.

- In July 2019, the Department of Justice and Public Safety informed PSIA of a potential fraud in one of their divisions. This has been elaborated on in further detail in the information provided directly from the Department of Justice and Public Safety below.

- The Public Engagement and Planning Division of Executive Council reported that they were informed of a suspected fraud by an employee of an organization funded by Government as follows:

  - An employee of the organization is alleged to have fraudulently purchased prepaid credit cards (potentially for personal use), forged cheques, and altered a bank statement.

  - The employee suspected of the alleged fraud was terminated.

  - The alleged fraud has been reported to the police for investigation.

- The Human Resource Secretariat (HRS) of Executive Council reported that, in July 2019, an external party falsely presented themselves as an employee of the public service and requested that funds/salary be directed to an alternate bank account. Proper procedures were not followed and the funds were transferred. Corrective action was taken with the employee who processed the request and the matter was reported to both the police and the Office of the Comptroller General (OCG).

- Service NL reported the following:
  - In November 2018, there were instances of suspected fraud involving three employees at the Motor Registration Division (MRD). These instances were reported to HRS and the police. Two of the employees have since been terminated from their positions. The third individual was suspended for six months and has since resigned from their position.
  - In May 2019, a report of suspected fraud was made involving an employee at a Government Services Centre. The incident was reported to the HRS. The individual was suspended with pay pending investigation and has since been terminated. The police have been contacted and are currently investigating this incident.
  - In June 2019, police arrested, and charged, an MRD employee. MRD, in consultation with HRS, suspended the individual with pay pending the results of the investigation and criminal proceedings. The individual was subsequently terminated.
- The Department of Transportation and Works (TW) reported the following:
  - Five TW employees purchased personal items on their Government travel card. Three of the employees received suspensions, while two employees were not disciplined due to delays in addressing the violations. The incidents involving the employees who were not disciplined were not investigated until after the deadline, as outlined in the collective agreement, had passed for issuing discipline. HRS and TW management informed the two employees that the use of the travel card for personal use is prohibited and may lead to disciplinary action. There has been no loss to Government as a result of these incidents. TW did not report these instances to police.
  - One employee breached policies related to the use of Government resources for potential personal gain. This breach was reviewed by TW and HRS and documented in the employee's personnel file. No loss to Government has been identified at this time in relation to this incident. TW did not report this matter to police.
  - Non-Government assets were stored by members of the general public in a Provincial building jointly occupied by TW employees and a private corporation. All non-Government assets were removed and TW staff have been advised that the use of Government buildings for personal use or non-Government business is deemed to be fraud and is a liability issue for Government. The local residents have also been notified that they will no longer be able to store their personal items in the building. There was no loss to Government as a result of this incident. This incident remains under investigation by the Department of Justice and Public Safety.

- The Department of Fisheries and Land Resources (FLR) reported the following:

  - There is an ongoing police investigation of an employee at FLR. The Government's group health insurance provider became aware of a questionable claim submitted by an employee. Government has discontinued this employee from paying into the insurance program.

  - A suspected fraud relating to revenue collected for domestic cutting permits was identified at a Forestry and Wildlife Branch satellite office. FLR completed an internal investigation and concluded sufficient evidence was found to support suspected fraud and breach of trust. The employee no longer works for FLR. The police are currently investigating this incident.

- The Department of Municipal Affairs and Environment (MAE) reported that, in May 2019, they requested that PSIA complete a special review of a funding recipient that was issued grants from the Community Enhancement Employment Program. MAE staff identified issues with project expenses claimed by the recipient. MAE staff also determined that some of these project expenses were also claimed in a program administered by the Department of Advanced Education, Skills and Labour. PSIA is currently concluding its review and therefore the loss to Government, if any, cannot be determined until this review is completed.

- The Department of Justice and Public Safety (JPS) reported that, in July 2019, a suspected fraud was identified in one of its divisions. Pursuant to Government's Fraud Management Policy, JPS conducted an internal investigation as well as engaged the HRS. JPS has communicated the suspected fraud to PSIA. The police have been contacted and are currently investigating this incident.

- The Department of Advanced Education, Skills and Labour (AESL) reported that, between April 2018 and May 2019, 26 cases of alleged client cheque fraud have been identified. These involved clients cashing a cheque on multiple occasions, usually through mobile deposit. In each instance, the OCG discovered the issue through its bank reconciliation process and stopped payment immediately. As a result, there was no loss to Government from these incidents. AESL also ensures that further payments to these clients are not advanced until direct deposit is established. These instances have been referred to the police for investigation.

- As part of the audit of the Public Accounts for the year ended March 31, 2019, my Office reviewed the audit working papers of significant Crown entities for which I am not the auditor. As a result of this review, my Office became aware of a significant deficiency in inventory at a Crown entity. During the 2018-19 audit, the entity's auditor reported that there was an issue with inventory identified for one location as part of the inventory count process. An employee was suspended and later terminated. The entity engaged a forensic auditor to investigate the matter. This investigation is ongoing.

During our audit of a claim administered by a Crown entity, my Office was informed of an instance of possible fraud whereby a former employee of the entity is alleged to have given preferential treatment to a vendor in exchange for monetary and other rewards from the vendor. The matter was referred to the police for investigation. The entity also filed a claim with its insurance company. My Office reported this matter to the Minister of Finance on January 18, 2019.

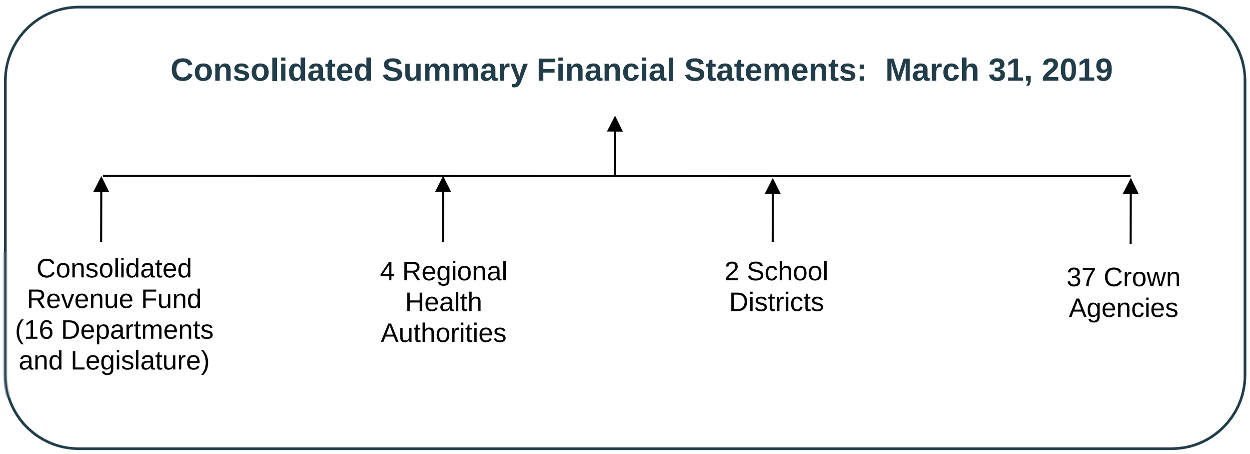
During our audit of the financial statements of the Support Enforcement Division of the Department of Justice and Public Safety (Support Enforcement), my Office became aware of four instances of possible fraud whereby four cheques, issued to four separate payees between April 2017 and March 2019, cleared the bank twice primarily due to the use of mobile banking technology. Support Enforcement identified the duplicate cheques during its monthly bank reconciliation process and was reimbursed by the bank. My Office reported this matter to the Minister of Finance on November 7, 2019.

In November 2019, AESL informed my Office of an instance of potential fraud by a vendor. A vendor is alleged to have committed cheque fraud by cashing the same cheque twice. The OCG detected the duplicate cheque being deposited and issued a stop payment on the cheque. As a result, there was no financial loss to Government. This instance of potential fraud has been reported to the police for investigation. My Office reported this matter to the Minister of Finance on December 3, 2019.

APPENDIX I

Government Reporting Entity

The Government Reporting Entity includes Government departments and the Legislature (known as the Consolidated Revenue Fund) and all other Government entities that are controlled by Government and are accountable to either a Minister of a Government Department or directly to the Legislature for the administration of their financial affairs and resources. 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.



In addition to Government departments and the Legislature, the Government Reporting Entity includes 43 other Government entities. The financial statements of these entities are audited by either the Office of the Auditor General or a private sector auditor.

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
Innovation and Business Investment Corporation	College of the North Atlantic
Livestock Owners Compensation Board	Conseil scolaire francophone provincial de Terre-Neuve et Labrador
Newfoundland and Labrador Arts Council	Credit Union Deposit Guarantee Corporation
Newfoundland and Labrador Crop Insurance Agency	Dairy Farmers of Newfoundland and Labrador
Newfoundland and Labrador Housing Corporation	Eastern Regional Health Authority

Audited by the Office of the Auditor General	Audited by a Private Sector Auditor
Newfoundland and Labrador Immigrant Investor Fund Limited	Egg Farmers of Newfoundland and Labrador
Newfoundland and Labrador Industrial Development Corporation	Labrador-Grenfell Regional Health Authority
Newfoundland and Labrador Legal Aid Commission	Marble Mountain Development Corporation
Newfoundland and Labrador Liquor Corporation	Memorial University of Newfoundland
Newfoundland and Labrador Municipal Financing Corporation	Multi-Materials Stewardship Board
Provincial Advisory Council on the Status of Women - Newfoundland and Labrador	Municipal Assessment Agency Inc.
Provincial Information and Library Resources Board	Nalcor Energy
Research & Development Corporation of Newfoundland and Labrador	Newfoundland and Labrador 911 Bureau Inc.
Student Loan Corporation of Newfoundland and Labrador	Newfoundland and Labrador Centre for Health Information
The Rooms Corporation of Newfoundland and Labrador	Newfoundland and Labrador English School District
	Newfoundland and Labrador Film Development Corporation
	Newfoundland and Labrador Sports Centre Inc.
	Newfoundland Hardwoods Limited
	Western Regional Health Authority
Unaudited	
Churchill Falls (Labrador) Corporation Trust [1]	
No Financial Statements Prepared	
Newfoundland and Labrador Farm Products Corporation [2]	

1 - No audit completed as not considered material.
2 - No audit completed as the entity is inactive.