OFFICE OF THE AUDITOR GENERAL

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

For the Year Ended March 31, 2014

Office of the Auditor General
Newfoundland and Labrador

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

VISION

The Office of the Auditor General is a highly valued legislative audit office recognized for assisting Members of the House of Assembly in holding Government accountable for the prudent use and management of public resources.

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AUDITOR
GENERAL
of Newfoundland and Labrador

November 2014

The Honourable Wade Verge, 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 Consolidated Summary Financial Statements of the Province for the year ended March 31, 2014.

Respectfully submitted,

TERRY PADDON, CA
Auditor General

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CHAPTER 1

COMMENTS OF THE AUDITOR GENERAL

Auditor General's Report

This Report, commenting on the financial statements of the Province of Newfoundland and Labrador, is my third as Auditor General of Newfoundland and Labrador. The Consolidated Summary Financial Statements reflect the financial position and annual operating results of all organizations in the Government Reporting Entity (GRE). This Report provides additional information and commentary on the Consolidated Summary Financial Statements of the Province for the year ended March 31, 2014.

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

Accountability

The Public Accounts are the most important documents which enable the House of Assembly, and all Newfoundlanders and Labradorians, to hold Government accountable for its stewardship of public funds.

The Consolidated Summary Financial Statements (Public Accounts) provide the most complete information about the financial position and operating results of the Province. They combine the financial position and operating results of central Government, Legislature and departments, with those of all other Government entities.

Financial Results

Deficit

The Province recorded a deficit of $389 million for the year ended March 31, 2014 - double the deficit recorded in 2012-13.

Offshore Revenue

In 2013-14, oil royalties were $2.1 billion, or 28.4% of total revenues. Oil royalties continue to represent a significant and volatile revenue source for Government. In 2011-12, oil royalties peaked at almost $2.8 billion.

The impact of the offshore sector on the overall revenues of the Province is even greater considering that a significant portion of corporate income tax, personal income tax, and other direct, indirect or induced revenues result directly from activity in the offshore sector as well.

While of significant importance to the economy and treasury of Newfoundland and Labrador, it is important to recognize that economic activity and revenue from the non-renewable resource sector is time limited and will diminish if not replaced.

Expenses

Since 2005, the Province's expenses have grown from $5.0 billion to $7.9 billion in 2014, an increase of $2.9 billion, or 58.0%. Per capita expenses in Newfoundland and Labrador are approximately 45% higher than the average of all other provinces and are the highest of all the provinces in Canada.

Tangible Capital Assets

In 2013-14, the Province spent $562 million on tangible capital assets (physical infrastructure) and a total of $4.0 billion from 2005 to 2014. Acquisitions of tangible capital assets from 2011 to 2014 averaged approximately $646 million - more than 2 times greater than the average annual acquisition of tangible capital assets from 2005 to 2010 - which was $244 million. As the Province attempts to balance its budget, continued spending on tangible capital assets at current levels are not likely sustainable.

Net Debt

The Net Debt of the Province at March 31, 2014 was $9.1 billion - an increase of $737 million from the previous year. Despite significant surpluses in 2010-11 and 2011-12, Net Debt has increased over the past four years. The beneficial impact of surpluses on Net Debt has been primarily offset by acquisitions of tangible capital assets during these periods.

Employee Future Benefits

The unfunded liability related to employee future benefits declined significantly in 2005-06, the year the $2 billion advance payment under the Atlantic Accord 2005 was directed to the Teachers' Pension Plan. In addition, further special payments totaling approximately $1.6 billion were made between 2006 and 2014 to address the unfunded pension liability. Since 2007-08, the unfunded liability has increased, such that, at March 31, 2014, the total unfunded liability is now greater than it was at March 31, 2005, despite in excess of $3.6 billion in special payments over that period. This reflects the inherent volatility related to this unfunded liability and the risks borne by the taxpayers of the Province for the retirement benefits of public employees.

Changes to Pension Plan and Other Post-retirement Benefits

During September 2014, Government and unions representing employees of the Public Service Pension Plan (PSPP) reached an agreement intended to address the sustainability of the PSPP. Government will pay $2.7 billion, amortized over 30 years, to address the unfunded liability of the PSPP. The unions have agreed to plan changes and increases in contribution rates. The agreement is contingent on implementing joint trusteeship, which means that both Government and unions will be responsible for the future sustainability of the PSPP and will share equally in any of the PSPP's surpluses and deficits. The Trustee, who will oversee the administration of the PSPP, will be an independent corporation. Legislation that will establish the framework for the joint trusteeship will be introduced in a future sitting of the House of Assembly. The plan changes and increases in contribution rates are targeted to become effective on January 1, 2015.

Changes have also been made to other employee future benefits provided by Government. Employees will now have to be eligible to receive a pension and have a minimum of 10 years of service to receive group health and group life insurance retirement benefits. Previously, employees had to be eligible to receive a pension and have just a minimum of 5 years of service to receive these benefits.

We have not been provided with the expected impact that these changes will have on the Province's financial position and future operating results. These changes could have a significant impact on Net Debt and on operating results.

Looking Forward

Deficits

The 2014 provincial budget presented a three year outlook which forecasted a deficit in 2014-15, followed by small surpluses in 2015-16 and 2016-17. As Government attempts to deal with deficits over the medium term, it will have to consider a number of alternative options - increasing revenue, decreasing expenses, borrowing or a combination of all. A major consideration in determining the response to potential deficits will be whether they are viewed as being temporary or more sustained. The answer will, to a large extent, depend on expectations of commodity prices and production levels.

The inherent volatility in commodity prices is highlighted by the current downturn in oil prices. While there is no certainty that oil prices will remain low, it does point to the risk to provincial revenue and the overall impact on provincial finances from factors outside the Province's control.

Demography

Demographic change is one of the most significant indicators, or predictors, of the future demands on public services. Demographic issues have impacted the revenues and expenses of the Province in previous years and will continue to do so in the future. These demographic issues include shifts in the population between various regions within the Province, migration to other jurisdictions and an aging population. Such issues will impact delivery of public services and the types of services required as well as their associated costs. Demographic change will also have a significant impact on labour markets.

Muskrat Falls

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

The Project is expected to cost $7.0 billion plus interest during construction of approximately $1.3 billion – a total cost of $8.3 billion. A portion of the Project has been financed through an issuance of bonds by Nalcor Energy's project subsidiaries in the amount of $5.0 billion. The bonds are fully guaranteed by the Government of Canada. The Province has also provided a guarantee to the Government of Canada to compensate it for any costs under this Guarantee which are triggered by legislative or regulatory actions of the Province. The Province and Nalcor Energy are currently expected to contribute equity to the Project in the amount of $2.8 billion with the balance being contributed by Emera through its minority partnership interest in the Labrador-Island Link. In addition, the Province has committed to funding all contingent equity which may be required to cover cost overruns on each aspect of the Project.

The size and complexity of the development creates considerable risk that the Province and the proponents will have to carefully manage during the construction phase. Ultimately, any risks related to project execution (including costs and timing) will be borne by the taxpayers, ratepayers, or both.

As at August 31, 2014, Nalcor Energy and/or its subsidiaries had spent or committed $5.0 billion related to the Project.

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

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

During the audit of the Consolidated Revenue Fund for the year ended March 31, 2014, I made inquiries of management related to fraud, as required by Canadian Auditing Standards. As a result of these inquiries, officials of the Department of Child, Youth and Family Services informed my Office of one instance of possible fraud. Officials of the Department informed my Office that the matter was reported to the Professional Services and Internal Audit Division of the Department of Finance and also to the police for follow-up. I reported this matter to the Minister of Finance on August 18, 2014.

During the audit of the Consolidated Summary Financial Statements for the year ended March 31, 2014, my Office became aware of a possible instance of fraud at the Western Regional Health Authority (the Authority). My Office made inquiries with officials of the Authority in relation to this matter. As a result of these inquiries, officials of the Authority informed my Office that the employee involved had been terminated and that the matter was reported to the police. Officials of the Authority further informed my Office that the matter is now before the Courts and that all funds identified as outstanding in relation to this matter have been repaid to the Authority. I reported this matter to the Minister of Finance on October 17, 2014.

Report issued pursuant to Section 16(1) of the *Auditor General Act*

Section 16.(1) of the *Auditor General Act* requires that *"The auditor general may, where in his or her opinion such an assignment does not interfere with the auditor general's primary responsibilities under this Act, whenever the Lieutenant-Governor in Council so requests or the House of Assembly or the Public Accounts Committee by resolution so requires, inquire into and report on a matter relating to the financial affairs of the province or to public property or inquire into and report on a person or organization that has received financial aid from the government of the province or in respect of which financial aid from the government of the province is sought."*

On May 8, 2014, the Lieutenant-Governor in Council requested that the Office inquire into and report on any and all aspects of a contract between the Department of Transportation and Works and Humber Valley Paving Ltd. related to Project Number 1-12PHP. The report resulting from this review was presented to the Minister of Finance on September 29, 2014.

Timeliness of Release of Financial Statements

In 2013, I commented that the relevance of the Province's financial statements was diminished due to the lateness of completion for the year ended March 31, 2012. Since then, the offices of the Comptroller General and the Auditor General have worked towards a goal of an earlier completion of the financial statements. I am pleased that as a result of the concerted efforts of staff at both offices, the audit report date related to the March 31, 2014 financial statements is October 10, 2014. This is a significant improvement from the previous year's audit report date of December 30, 2013.

Acknowledgements

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

TERRY PADDON, CA
Auditor General

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CHAPTER
2
OUR OFFICE

The Office of the Auditor General operates from two locations - Mount Pearl and Corner Brook. The staff of the Office contribute, as a team, towards the audit of the Public Accounts of Newfoundland and Labrador.

The following is the staff of the Office of the Auditor General as of September 30, 2014:

Nicole Abbott, CA
Marc Blake
Paul Burggraaf, CAPM
Greg Butler
Keith Butt, CA
John Casey, CMA
Gertrude Critch
Tony Dingwell, CA
Lisa Duffy, CA
Chris Fudge
Robert George
Gregg Griffin
Cayla Hillier, CMA
Jeremy Hynes
Travis Ivany
Brenda Kavanagh
Trena Keats, CA
Nancy King
Melissa Lewis
Stephanie Lewis, CA
Ruochen Li
Michael MacPhee, CA
Adam Martin, CA
Leif Martin, CA
Jayme Martin, CA
Trevor McCormick, FCGA
Patrick Morrissey
Melissa Mullaly, CMA
Jessica Nugent, CA
Tracy Pelley, CMA
Thomas Pritchard, CA
Pauline Reynolds, CMA
Sandra Russell, CA
Allison Simms
Lindy Stanley, CA
Brad Sullivan, CA
Scott Walters, FCA
Tony Wiseman

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CHAPTER
3
INTRODUCTION

Background

This Report provides information on the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador for the year ended March 31, 2014. These financial statements are the principal means by which Government reports to the House of Assembly and to all Newfoundlanders and Labradorians on its stewardship of public funds.

This Report presents commentary on certain financial information contained in the financial statements. Two appendices are also included. Appendix I presents answers to questions which are frequently asked in relation to the Public Accounts, while Appendix II presents a glossary of terms used in the Public Accounts.

Legislative Requirements

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

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

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

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

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

Consolidated Summary Financial Statements

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

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

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

GBEs and Government Business Partnerships generate their revenues by selling goods or services outside of the GRE. Their operations are self-sustaining - they do not rely on government funding. The GBEs are Nalcor Energy and the Newfoundland and Labrador Liquor Corporation. During 2013-14, the Province began to include its equity interest (25%) in the Atlantic Lottery Corporation Inc. as a Government Business Partnership. The accounting for GBEs and Government Business Partnerships is significantly different from all of the other organizations in the GRE, reflecting their self-sustaining nature.

Table 1

Consolidated Summary Financial Statements
Government Reporting Entity
March 31, 2014

Audited by the Office of the Auditor General	Audited by a Private Sector Auditor
Business Investment Corporation	Atlantic Lottery Corporation Inc.
C.A Pippy Park Commission	Board of Commissioners of Public Utilities
Consolidated Revenue Fund	Central Regional Health Authority
Heritage Foundation of Newfoundland and Labrador	Chicken Farmers of Newfoundland and Labrador
Livestock Owners Compensation Board	College of the North Atlantic
Newfoundland and Labrador Arts Council	Conseil scolaire francophone provincial de Terre-Neuve et Labrador
Newfoundland and Labrador Crop Insurance Agency	Credit Union Deposit Guarantee Corporation
Newfoundland and Labrador Housing Corporation	Dairy Farmers of Newfoundland and Labrador

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

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

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

For the year ended March 31, 2014, the Public Accounts contains the Consolidated Summary Financial Statements, the Independent Auditor's Report on those financial statements, and other information which Government is required to include or chooses to include.

Responsibility for the Public Accounts

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

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

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

Independent Auditor's Report

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

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

Level of Assurance

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

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

Materiality

The Independent Auditor's Report provides an opinion on whether the Consolidated Summary Financial Statements present fairly, in all material respects, the consolidated financial position of the Province at a point in time (e.g.; March 31, 2014), 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, 2014) in accordance with Canadian Public Sector Accounting Standards.

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

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

Audit Procedures and Evidence

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

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

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

Audit Opinion

An unqualified audit opinion was issued on the Consolidated Summary Financial Statements for the year ended March 31, 2014, concluding that they were fairly presented, in all material respects, in accordance with Canadian Public Sector Accounting Standards.

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

CHAPTER
4
UNDERSTANDING THE CONSOLIDATED SUMMARY FINANCIAL STATEMENTS

Introduction

The Consolidated Summary Financial Statements present the most comprehensive view of the financial position of the Province as at March 31, 2014. Included with the financial statements, the Department of Finance provides a commentary - *Understanding the Financial Health of the Province of Newfoundland and Labrador.* This commentary is intended to provide readers of the financial statements with additional tools to be able to assess the information contained in the financial statements.

The Office of the Auditor General also adds to the understanding and interpretation of the financial results. This report contains additional commentary and highlights specific issues we feel are important to understanding the financial condition of the Province.

Understanding the Consolidated Summary Financial Statements

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

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

Consolidated Statement of Financial Position

This statement provides a snapshot of the financial position of the Province at a point in time - the end of the fiscal year (e.g.; March 31, 2014). Comparative figures are also shown for the same point in time the previous year. This allows the reader to be able to make comparisons and consider trends related to financial results.

There are five main components that make up the financial position of the Province. Table 1 outlines the components of the Consolidated Statement of Financial Position at March 31, 2014.

Table 1

Consolidated Summary Financial Statements
Components of the Consolidated Statement of Financial Position
As at March 31, 2014
($000s)

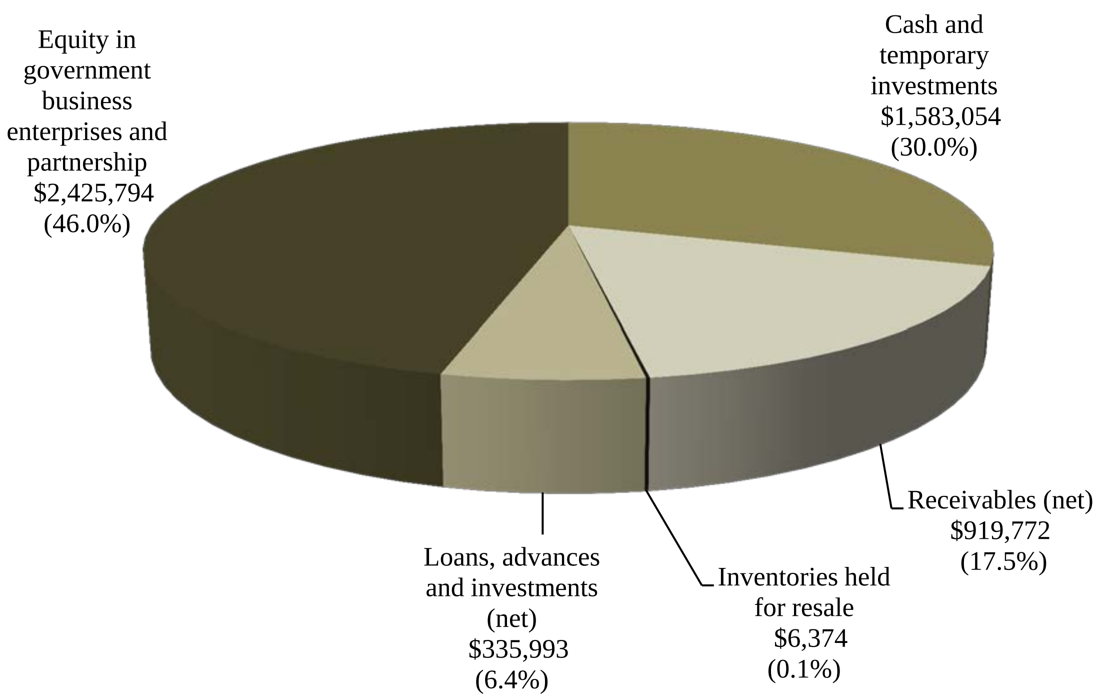
Component	Amount
Financial Assets	$ 5,270,987
Liabilities	14,355,939
Net Debt	**9,084,952**
Non-financial Assets	4,148,253
Accumulated Deficit	**$ 4,936,699**

Financial Assets

Financial assets are those that could be used to discharge existing liabilities or finance future operations. Chart 1 shows the financial assets of the Province for the year ended March 31, 2014.

Chart 1

Consolidated Summary Financial Statements
Financial Assets
As at March 31, 2014
($000s)



Total: $5,270,987

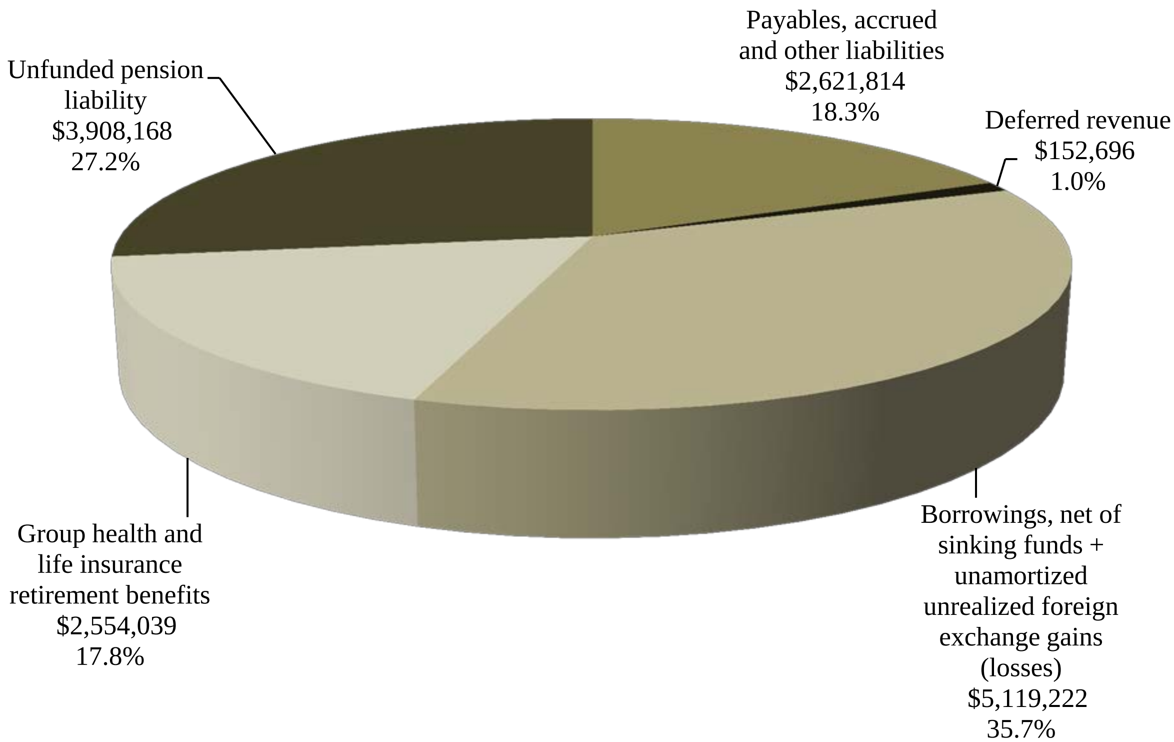
Equity in Government Business Enterprises and partnership reflects the net assets (assets less liabilities) of Nalcor Energy, the Newfoundland and Labrador Liquor Corporation, and Government's equity interest in the Atlantic Lottery Corporation, Inc. This equity is used by these entities to generate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

Liabilities

Liabilities represent amounts that are payable or will be required to be paid to third parties and include amounts payable in the normal course of operations, deferred revenue, amounts due to bond holders and other lenders that have provided money to finance the Province's operations and amounts the Province is responsible for related to employee future benefit obligations. Chart 2 shows the liabilities of the Province as at March 31, 2014.

Chart 2

Consolidated Summary Financial Statements
Liabilities
As at March 31, 2014
($000s)



Total: $14,355,939

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, 2014 was $9.1 billion. (2013 - $8.3 billion).

Non-financial assets

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

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

Non-financial assets of the Province at March 31, 2014 were:

• Tangible capital assets	$4.06 billion
• Prepaid expenses, deferred charges and inventories	0.09 billion
Total Non-financial Assets	$4.15 billion

Accumulated Deficit

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

The accumulated deficit of the Province at March 31, 2014 was $4.9 billion (2013 - $4.4 billion).

Consolidated Statement of Change in Net Debt

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

1. Surplus or deficit for the year

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

2. Changes in Tangible Capital Assets

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

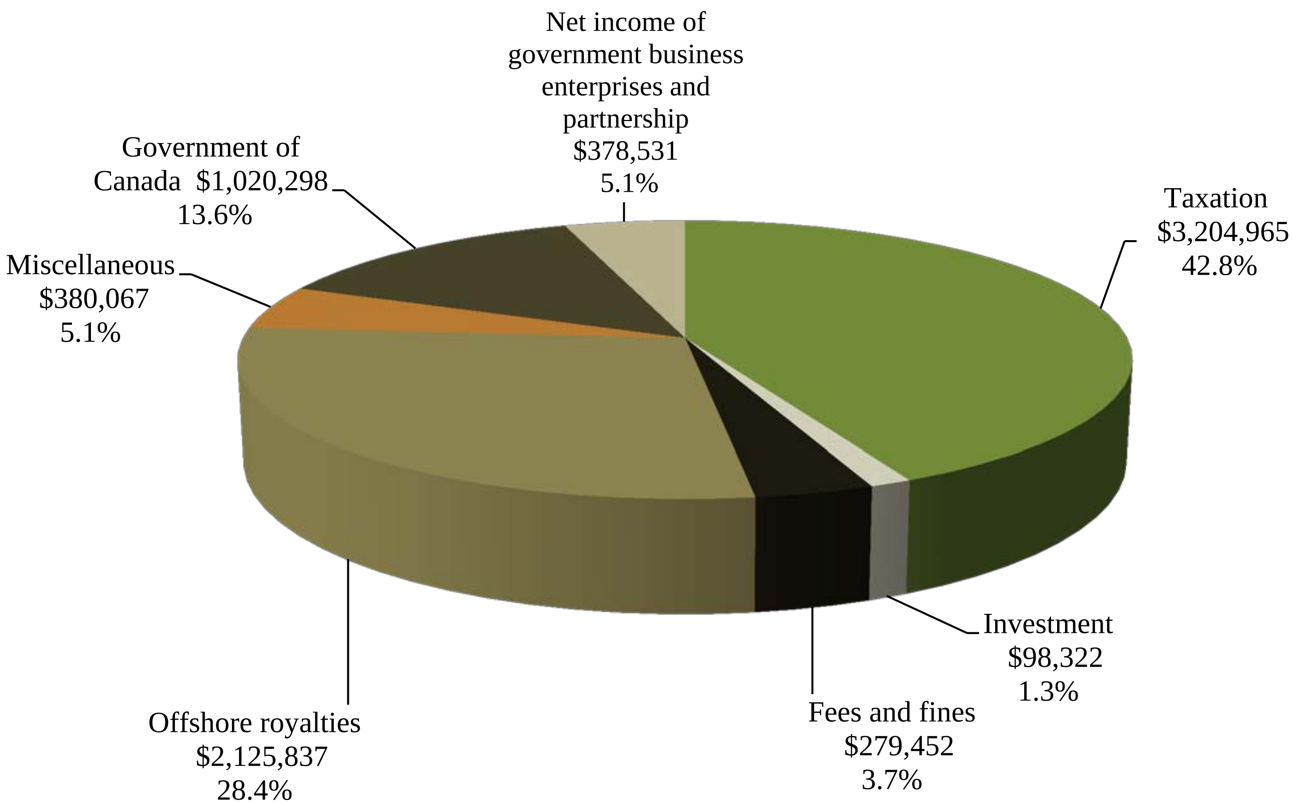
Consolidated Statement of Operations

This statement shows the results of the operations of the Government Reporting Entity for the year April 1, 2013 to March 31, 2014, including the Consolidated Revenue Fund (central Government, Legislature and departments) and the 45 Crown corporations, boards, and authorities that are controlled by the Government of Newfoundland and Labrador. These results are compared to the original estimates that were presented to the legislature and approved as part of the budget process.

The statement provides the amount of revenue that the Province generated during the year and is broken down by major categories. Chart 3 shows the revenues of the Province by source for the year ended March 31, 2014. Approximately 28% of the Province's total revenues came from offshore royalties.

Chart 3

Consolidated Summary Financial Statements
Revenues by Source
Year Ended March 31, 2014
($000s)

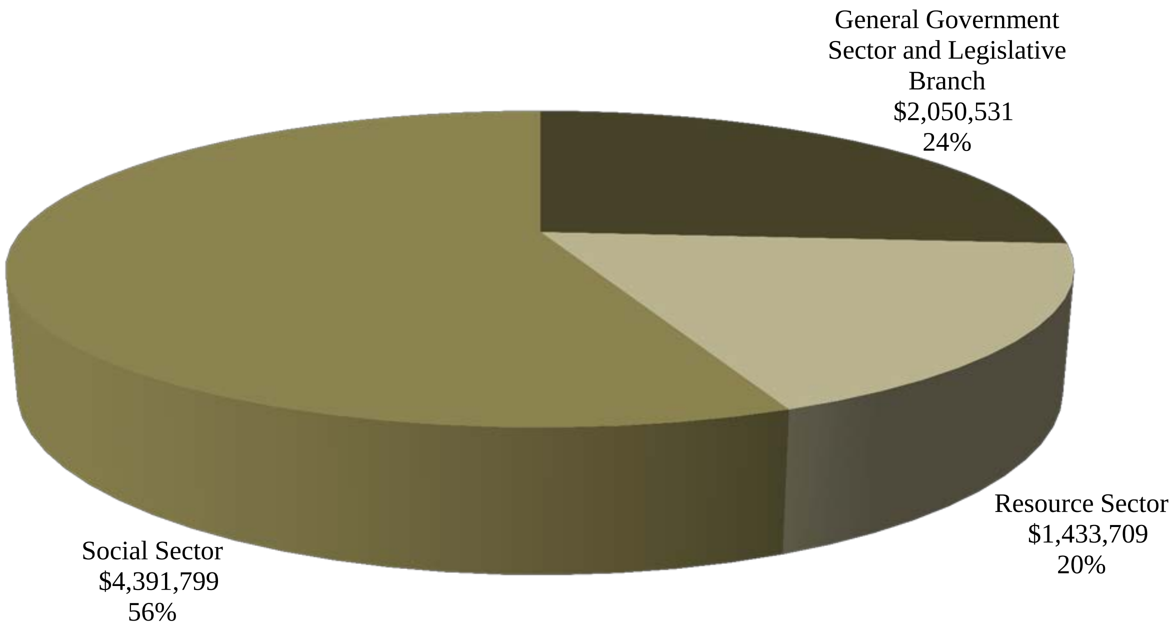


Total: $7,487,472

The statement also provides information on the expenses incurred by the Province during the year by major functional area. Chart 4 shows the expenses of the Province by major functional area for the year ended March 31, 2014. Approximately 56% of the Province's total expenses of $7.9 billion were spent in the social sector.

Chart 4

Consolidated Revenue Fund Financial Statements
Expenses by major functional area
Year Ended March 31, 2014
($000s)



Total: $7,876,039

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

The Province has recorded a deficit of $389 million for the year ended March 31, 2014 (2013 - $195 million deficit).

Consolidated Statement of Changes in Accumulated Deficit

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

The accumulated deficit at the end of the fiscal year is also impacted by adjustments to the opening balance of accumulated deficit. For the year ended March 31, 2014, these adjustments primarily resulted from:

- First time adoption of Public Sector Accounting Standards by certain entities forming part of the GRE.

- Differences between the accounting policies of the Consolidated Revenue Fund and those of a Government Business Enterprise.

Consolidated Statement of Cash Flows

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

- Operations
- Capital Transactions
- Financing Activities
- Investing Activities

Notes to the Consolidated Financial Statements and Schedules

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

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CHAPTER
5
THE FINANCIAL CONDITION OF THE PROVINCE

Introduction

The commentary prepared by the Department of Finance, *Understanding the Financial Health of the Province of Newfoundland and Labrador,* is included with the Public Accounts Volume I, Consolidated Summary Financial Statements. It highlights certain elements of the financial statements and also provides commentary and analysis on certain indicators of the financial condition of the Province. Individuals are encouraged to read this commentary.

In this chapter, we provide information on how a reader can interpret the financial condition of the Province from the Consolidated Summary Financial Statements. Certain key financial indicators are examined in detail. Where appropriate and available, comparative information from other provinces in Canada has been included. We have included data for a ten year period (where available) which should allow readers of this report and the financial statements to look at long-term trends which provide further indicators of whether a government is living within its means and whether financial circumstances are improving or deteriorating. To further allow readers to assess expected future direction, we have also included forecasted information, where available. The forecasted financial information for 2015, 2016, and 2017 was obtained from Budget 2014.

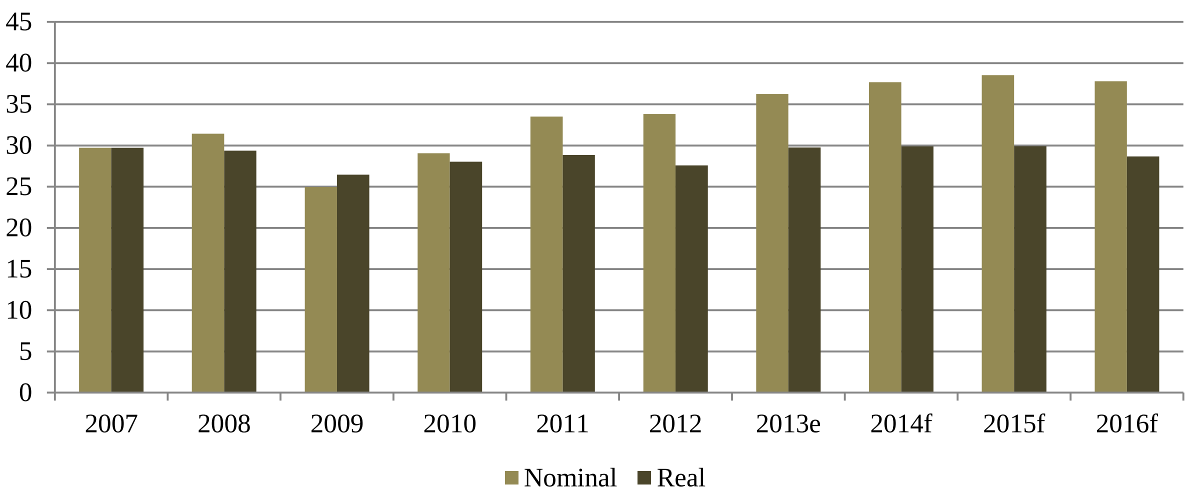
Economic Growth

GDP

Chart 1 shows real and nominal GDP for the Province for the years 2007 to 2013, as well as the forecast for 2014 to 2016.

Chart 1

Province of Newfoundland and Labrador
Nominal and Real GDP
Years ended
($ Billions)



Source: Department of Finance

Real GDP is virtually unchanged from $29.7 billion in 2007 to a forecast amount of $29.9 billion in 2014. During the same period, nominal GDP increased from $29.7 billion to $37.7 billion, representing an average annual growth of about 4% per year.

Observation

- Real GDP is virtually unchanged from $29.7 billion in 2007 to a forecast amount of $29.9 billion in 2014.

Real GDP reflects the effect of changing levels of production of goods and services in the Province each year. An unchanged level of real GDP would indicate that there has been no change in the overall level of goods and services produced during this time period. The increase in nominal GDP during the same time period highlights the significant impact that increasing commodity prices have had on GDP growth over the period.

Chart 1 also highlights the impact of the volatility of commodity prices on the Province's GDP. For example, from 2009 to 2010, nominal GDP increased by $4.1 billion while the real GDP only increased by $1.6 billion. Also, from 2008 to 2009, nominal GDP decreased by $6.5 billion, which is significantly more than the decrease of $2.9 billion in real GDP. This reflects a significant decline in commodity prices over a short period of time.

Economic Forecast

Chart 1 also provides the most recent public forecast of GDP for Newfoundland and Labrador published by the Department of Finance. This forecast shows a decline in real GDP over the forecast period to 2016. The forecast shows an increase in nominal GDP over the same period, however, the current softening of commodity prices has the potential to negatively impact provincial economic growth and provincial revenues.

Observations

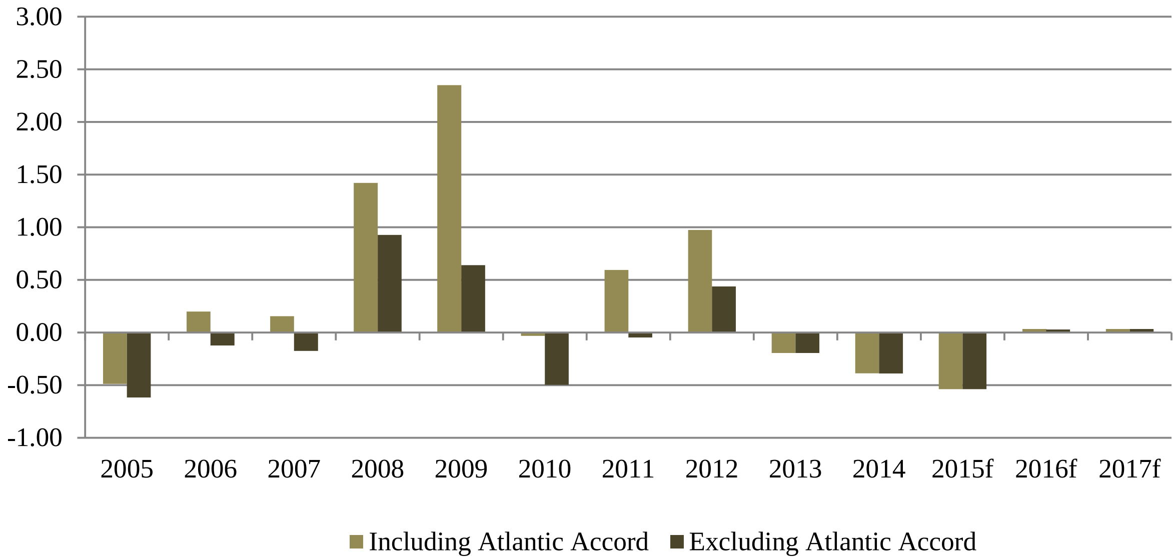
- Real GDP is forecast to decline from 2014 to 2016.
- Nominal GDP has the potential to be negatively impacted by the current softening of commodity prices with an associated impact on provincial revenues.

Surplus/(Deficit)

Chart 2 provides a summary of the surpluses and deficits recorded by the Province from 2004-05 to 2013-14, as well as the Province's forecast for the subsequent 3 years.

Chart 2

Consolidated Summary Financial Statements
Surplus/(Deficit)
Years Ended March 31
($ Billions)



The surpluses that the Province has experienced in recent years have primarily been the result of increased offshore royalties and payments received from the Federal Government under the Atlantic Accord Agreements. The amount of revenue received from offshore royalties is dependent upon world oil prices, the exchange rate, and production levels. World oil prices are highly volatile and production levels relating to non-renewable resources can vary significantly. Changes in these factors can result in significant variability in revenue from year to year.

The net cumulative value of the surpluses less deficits for 2004-05 to 2013-14 is $4.6 billion. This has contributed to the reduction in Net Debt of $2.8 billion since 2004-05.

Chart 2 also shows the impact that payments received under both the Atlantic Accord 1985 and the Atlantic Accord 2005 have had on the surpluses or deficits recorded for the years ended March 31, 2005 to 2012. Since 2004-05, the Province has received approximately $4.6 billion under these agreements. The net cumulative value of surpluses over the past ten years of $4.6 billion would have been a net cumulative deficit of approximately $41 million in the absence of revenue from the Atlantic Accord agreements. 2011-12 was the last year that the Province received any payments under the Atlantic Accord agreements.

Observation

- The cumulative value of surpluses recorded by the Province from 2004-05 to 2013-14 of $4.6 billion was, almost, entirely the result of payments received under the Atlantic Accord arrangements.

Projected Deficit

A deficit of $538 million is forecast for 2014-15, which would be the third deficit in a row, followed by small surpluses in 2015-16 and 2016-17. Should the current softness in commodity prices persist, this has the potential to significantly impact the forecast deficit in 2014-15 and the Province's plan to return to surplus by 2015-16.

Observations

- The forecast deficit of $538 million in 2014-15, will be the third deficit in a row.
- The current softness in commodity prices has the potential to significantly impact the forecast deficit in 2014-15 and the Province's plan to return to surplus by 2015-16.

As Government plans for the medium term, it will have to consider a number of alternative options to deal with expected deficits - increasing revenue, decreasing expenses, borrowing or a combination of all. A major consideration in determining a response will be whether any expected deficit is viewed as being temporary or more sustained. The answer will, to a large extent, depend on expectations of commodity prices and production levels.

Net Debt

The Consolidated Statement of Financial Position provides details of the components of Net Debt. In simple terms, Net Debt equals all the liabilities of the Province less its financial assets. Net Debt of the Province at March 31, 2014 was $9.1 billion.

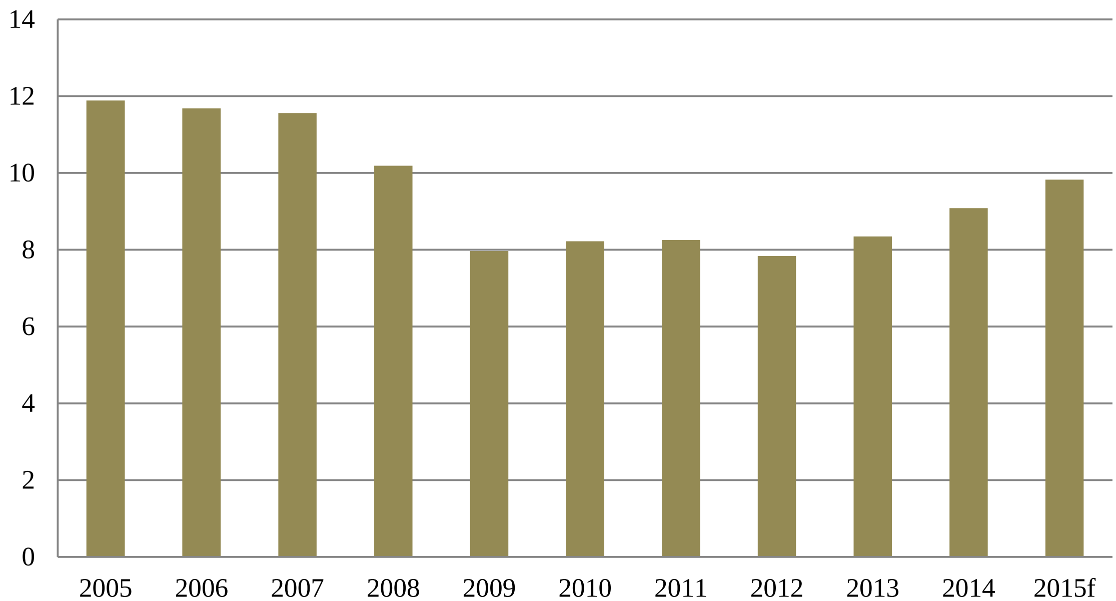
Liabilities are amounts that the Province owes others. Liabilities consist of those items which are payable for items purchased in the ordinary course of doing business, amounts borrowed and which will be repaid over a longer time frame and obligations related to employee future benefits. These benefits 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, inventories held for resale and equity in government business enterprises (GBEs) and partnerships. The GBEs of the Province of Newfoundland and Labrador are Nalcor Energy and its subsidiaries and the Newfoundland and Labrador Liquor Corporation. During 2013-14, the Province began to include its equity interest in the Atlantic Lottery Corporation as a Government Business Partnership.

Chart 3 shows Net Debt for the years ended March 31, 2005 through to the forecast amount at March 31, 2015.

Chart 3

Consolidated Summary Financial Statements
Net Debt
Years Ended March 31
($ Billions)



Net Debt is impacted by surpluses or deficits and the purchase of tangible capital assets less related amortization.

In order to reduce Net Debt, Government will need to record surpluses greater than the net change in its tangible capital assets.

At March 31, 2014, Net Debt had increased by approximately $1.2 billion from its low point in 2011-12, primarily the result of deficits in 2012-13 and 2013-14 plus acquisitions of tangible capital assets during these periods.

In 2013-14, Net Debt has increased by $737 million. Continued investment in tangible capital assets combined with a significant deficit has contributed to the rise in Net Debt. While no information has been provided as to the expected level of spending on tangible capital assets in 2015-16, the forecasted cumulative net deficits totaling $477 million for the period 2014-15 to 2016-17 indicate Net Debt will rise at least by that amount in addition to any net spending on tangible capital assets.

The level of Net Debt by March 31, 2016 can be expected to exceed the level at March 31, 2008.

Observations

- Net Debt has increased by approximately $1.2 billion since its low point in 2011-12.
- The net cumulative deficit of $477 million forecast by the Province over the next three years plus any net investment in tangible capital assets will increase Net Debt over this period.
- By March 31, 2016, Net Debt will likely exceed $10 billion.

Changes to Employee Future Benefits

During September 2014, Government and unions representing employees of the Public Service Pension Plan (PSPP) reached an agreement to address the sustainability of the PSPP. Government will pay $2.7 billion, amortized over 30 years, to address the unfunded liability of the PSPP. The unions have agreed to plan changes and increases in contribution rates. The agreement is contingent on implementing joint trusteeship, which means that both Government and unions will be responsible for the future sustainability of the PSPP and will share equally in any of the PSPP's surpluses and deficits. The Trustee, who will oversee the administration of the PSPP, will be an independent corporation. Legislation that will establish the framework for the joint trusteeship will be introduced in a future sitting of the House of Assembly. The plan changes and increases in contribution rates are targeted to become effective on January 1, 2015.

Changes have also been made to other employee future benefits provided by Government. Employees will now have to be eligible to receive a pension and have a minimum of 10 years of service to receive group health and group life insurance retirement benefits. Previously, employees had to be eligible to receive a pension and have just a minimum of 5 years of service to receive these benefits.

We have not been provided with the expected impact that these changes will have on the Province's financial position and future operating results. These changes could have a significant impact on Net Debt and on operating results.

Observation

- The expected impact of recently negotiated changes to the Public Service Pension Plan on the financial position of the Province or future operating results has not been provided. These changes could have a significant impact on Net Debt and on operating results.

Net Debt as a Percentage of GDP

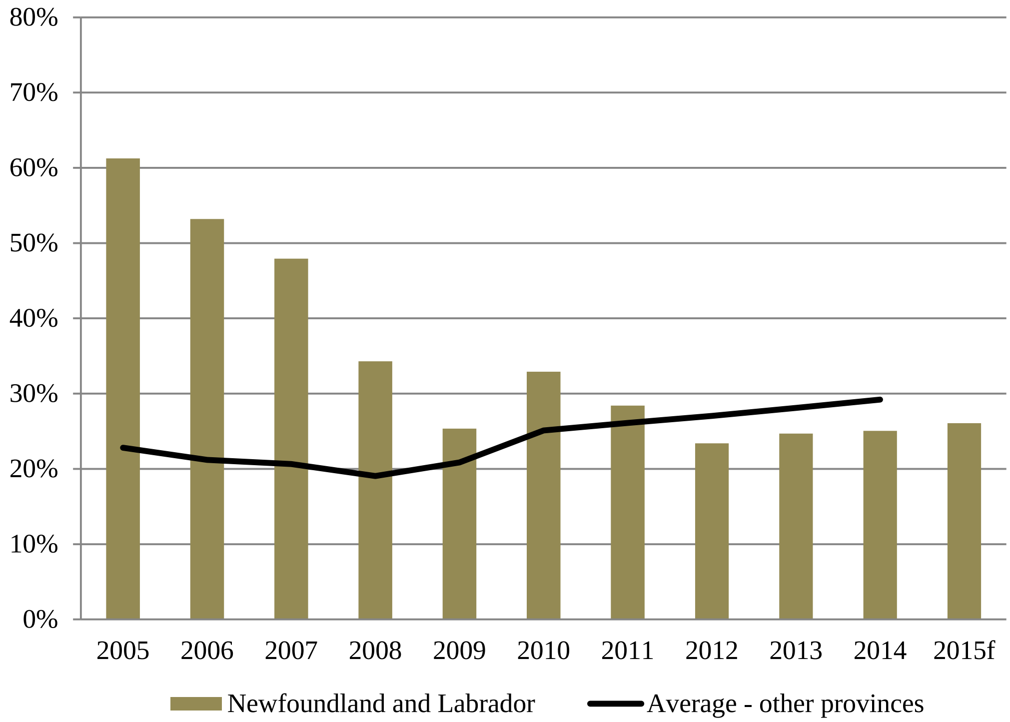
GDP is a measure of the value of goods and services produced by a jurisdiction in one year. It is the measure most often used to indicate the size and strength of a provincial economy. Government must manage its revenue raising and spending practices in the context of the economy of the Province.

GDP provides an indication 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 government's Net Debt as a percentage of GDP is high it may not be sustainable.

Chart 4 shows Net Debt as a percentage of GDP from 2005 to 2015.

Chart 4

Consolidated Summary Financial Statements
Net Debt as a Percentage of GDP
Years Ended March 31



Net Debt as a percentage of GDP has declined from a high of 61.3% in 2005 to 25.0% in 2014. Furthermore, in 2014 the Province's Net Debt as a percentage of GDP was lower than the average of all other provinces.

Net Debt as a percentage of GDP has deteriorated slightly in 2014 as a result of the deficit recorded for the year. Given that an overall deficit is forecast for 2014-15 to 2016-17, this indicator is likely to continue to further deteriorate in the near term.

Observation

- The ratio of Net Debt to GDP can be expected to deteriorate in the near term as GDP growth slows and net cumulative deficits are recorded over the period.

Net Debt as a percentage of total annual revenue

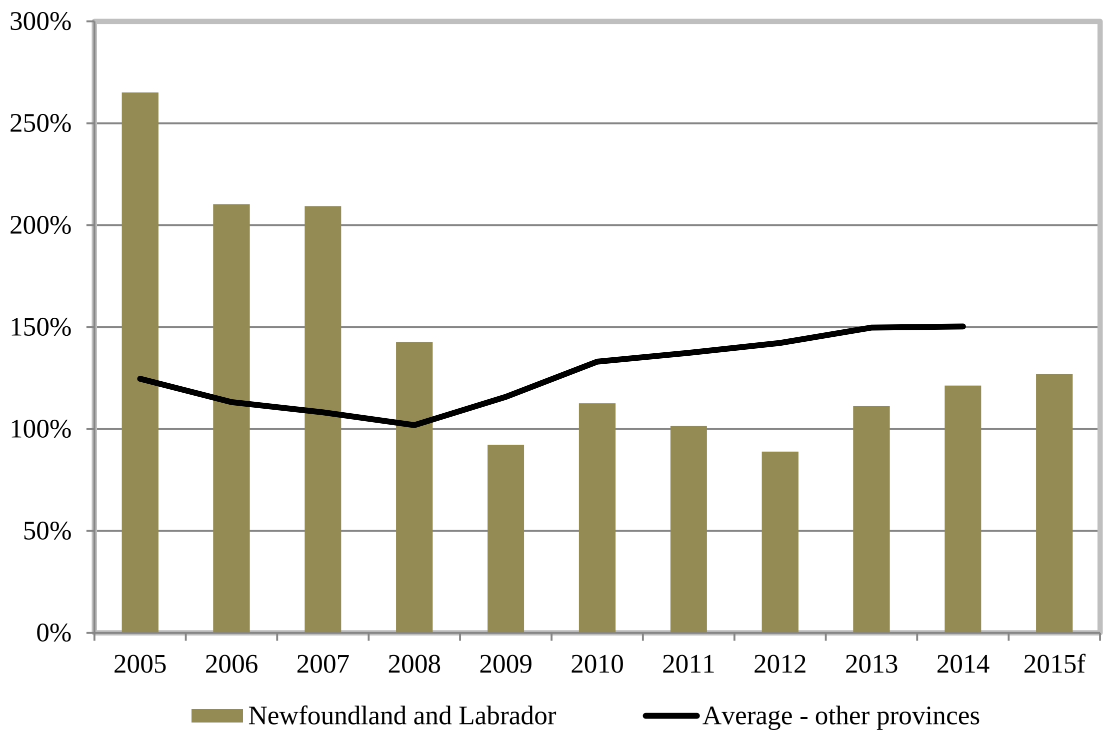
Net Debt is the amount which the government of the day leaves for future governments to repay. The ability to repay this debt is dependent, to a large extent, on the ability of the Province to generate sufficient revenue in the future.

It is useful to compare Net Debt to total annual revenue. A percentage that is increasing would indicate that more time will be needed to repay Net Debt and may not be sustainable.

Chart 5 shows Net Debt as a percentage of total annual revenue from 2005 to 2015.

Chart 5

Consolidated Summary Financial Statements
Net Debt as a percentage of total annual revenue
Years Ended March 31



Net Debt as a percentage of total annual revenue has improved considerably since 2005 and has averaged approximately 107% from 2010 to 2014. This would indicate an improved ability to reduce Net Debt.

However, Net Debt as a percentage of total annual revenue has risen to approximately 121% in 2014 and is expected to rise to approximately 127% in 2015. If this trend continues, the Province would have more difficulty reducing Net Debt in the future.

Observation

- Net Debt as a percentage of revenue has deteriorated since 2011-12 and this trend is expected to continue to 2014-15 – a further indicator that reductions in Net Debt will be difficult in the near term.

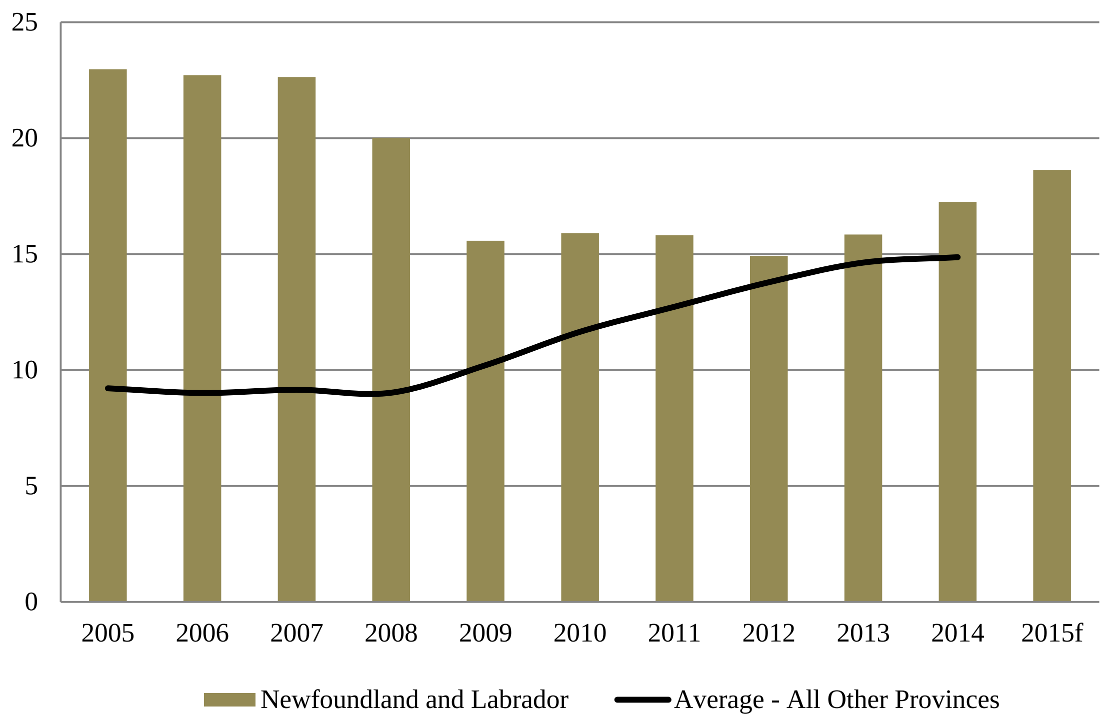
Net Debt Per Capita

Government Target for Net Debt per Capita

In Budget 2012, Government established a target of having Net Debt per capita equal the average of all other provinces within 10 years. Chart 6 shows the Province's Net Debt per capita as compared to the average of all other provinces for the years March 31, 2005 to 2015.

Chart 6

Province of Newfoundland and Labrador
Net Debt per Capita Compared to Average of All Other Provinces
Years Ended March 31
($000s)



Source: Public Accounts - all provinces; Statistics Canada

For several years, the Province's Net Debt per capita was approaching the average of all other provinces. This occurred as a result of an improvement in the Province's Net Debt per capita from 2008 and 2012, and a deterioration of the average of all other provinces during that time. However, since 2013 the difference between the Province's Net Debt per capita and the average of all other provinces has started to increase. While this target is dependent on the results in other provinces as well as those of Newfoundland and Labrador, given the medium term forecast, the gap between the Province and the average of all other provinces is likely to widen, making the achievement of this target more difficult.

Observation

- Given the current trend, the Province will find it difficult to achieve the Net Debt per Capita target it established in Budget 2012.

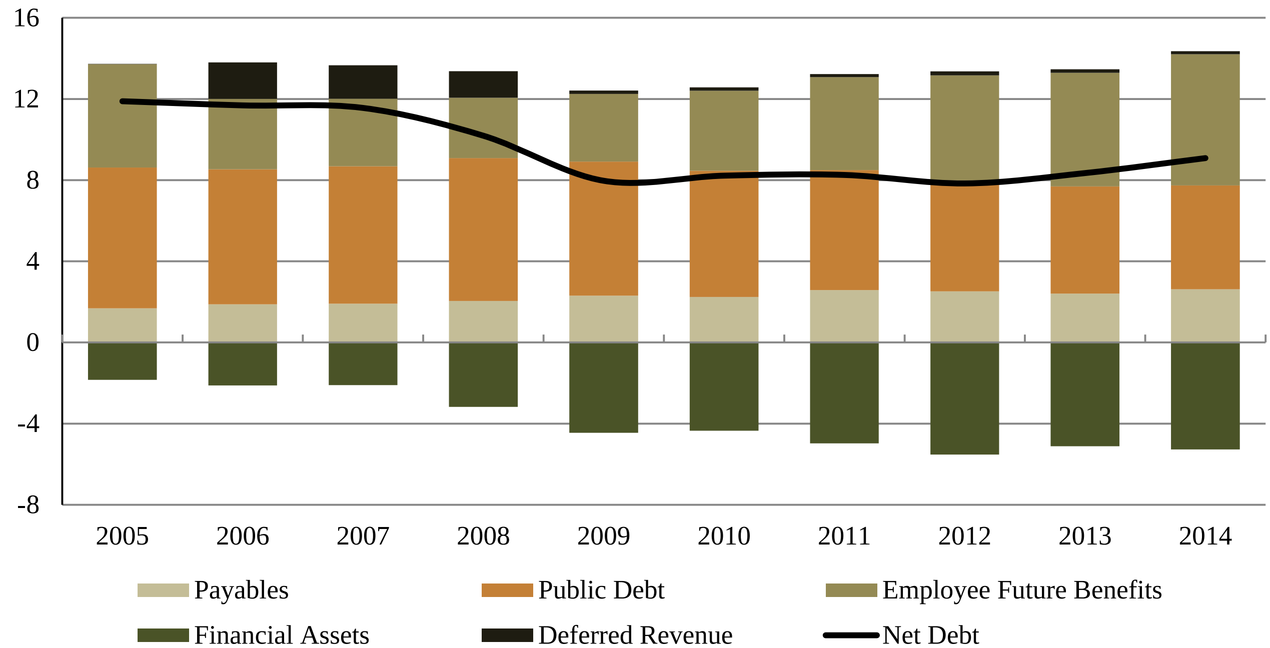
For the year ended March 31, 2014, the Province's Net Debt per capita has increased by approximately $1,500, from approximately $15,800 to approximately $17,300. The deficit of $389 million for the year ended March 31, 2014, contributed to this increase. Furthermore, the Province's Net Debt per capita is expected to increase to approximately $18,600 by March 31, 2015. If Government continues to incur deficits in the future, the Province's Net Debt per capita may soon approach the 2008 amount of $20,000.

Components of Net Debt

While the overall level of Net Debt has declined since its peak at March 31, 2005, the component parts show mixed results. Chart 7 shows the components of Net Debt for the years ended March 31, 2005 to 2014.

Chart 7

Consolidated Summary Financial Statements
Net Debt and its Components
Years Ended March 31
($ Billions)



Financial Assets

Financial assets have increased by approximately $3.4 billion from 2004-05 to 2013-14. Cash and temporary investments have increased by approximately $0.8 billion, other financial assets have increased by approximately $0.7 billion, and equity in government business enterprises and partnership has increased by approximately $1.9 billion over this period.

Public Debt

The Public Debt component, the actual borrowing of Government in capital markets, has decreased by approximately $1.8 billion from 2004-05 to 2013-14. This has occurred, primarily, because debt has been repaid as it has come due.

Employee Future Benefits

On the other hand, the liability for employee future benefits has seen significant variability over the same period. Employee future benefits include obligations related to Provincial employee pension arrangements and group health and life insurance benefits which are generally cost shared with provincial retirees.

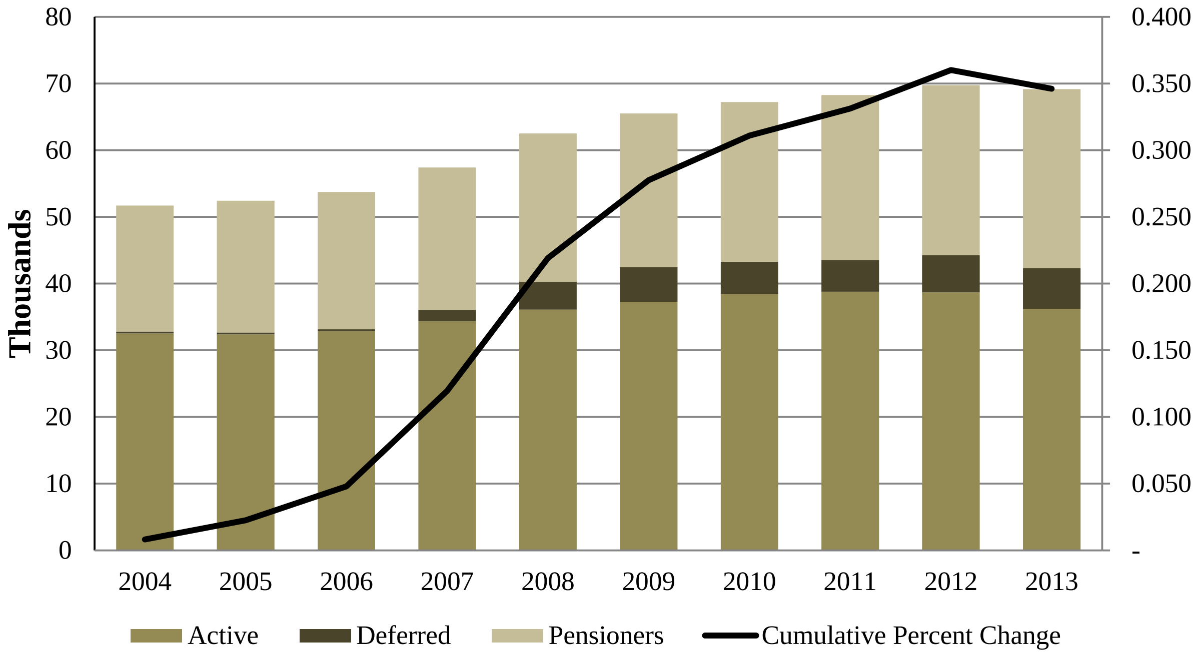
Pension Beneficiaries

The unfunded liability related to Government sponsored pension plans arises from the nature of the plans and the legislative framework around the plans. The Province provides its employees with a "defined benefit" plan which promises to pay specified amounts upon retirement. If there are insufficient funds available to meet this obligation, the Province is responsible for any shortfall. The *Pension Funding Act* provides a deficiency guarantee by the Province to cover any deficiency shortfall under the Government employee pension plans.

Chart 8 shows the number of Public Service Pension Beneficiaries (individuals who are active participants, have a pension benefit deferred, or are receiving pension benefits) for the years ended December 31, 2004 to 2013.

Chart 8

Province of Newfoundland and Labrador
Public Service Pension Beneficiaries
Years Ended December 31



Source: Department of Finance

As Chart 8 indicates, the number of Public Service Pension Beneficiaries has increased from approximately 52,000 in 2004 to approximately 69,000 in 2013 - an increase of 17,000 or 33%. Of this increase, 8,000 or 47% is the result of an increase in the number of individuals receiving pension benefits. The increase in the number of beneficiaries has contributed to the increase in obligations related to employee future benefits.

Observation

- Beneficiaries under the Public Service Pension Plans have increased by 17,000, or 33%, since 2004.

Pension Plans

Note 7 to the Consolidated Summary Financial Statements provides details of the determination of the unfunded pension liability. Six pension plans are included in the determination of the liability:

- Public Service
- Teachers'
- Memorial University of Newfoundland
- Uniformed Services
- Members of the House of Assembly
- Provincial Court Judges'

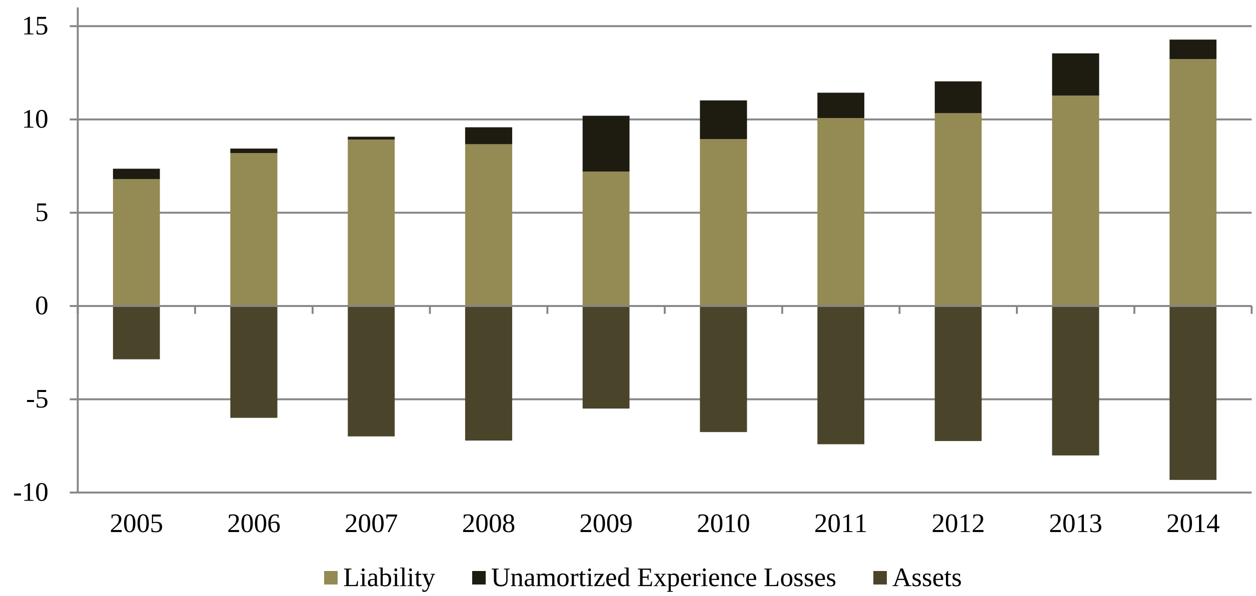
Actuaries measure the expected pension benefits to be paid to employees over time. This measurement would take into consideration such factors as expected changes in wage rates, expected retirement dates and mortality rates. Actuaries estimate the assets required today, and which would be expected to earn a return over the long term, in order to be able to pay the expected benefits as they come due. If the assets which are currently available are less than the actuary indicates should be available, the difference represents the unfunded pension liability. In other words, insufficient money is available today to be able to meet future obligations.

The money that currently is available for pensions is invested in a variety of areas - equities, bonds and real estate. Actuaries make an assumption as to the overall annual expected earnings of these investments. The current assumptions range from 6.3% to 6.75%.

Chart 9 shows the components of the Province's unfunded pension liability for the years ended March 31, 2005 to 2014.

Chart 9

Consolidated Summary Financial Statements
Unfunded Pension Liability Components
Years Ended March 31
($ Billions)



Group Health and Life Insurance

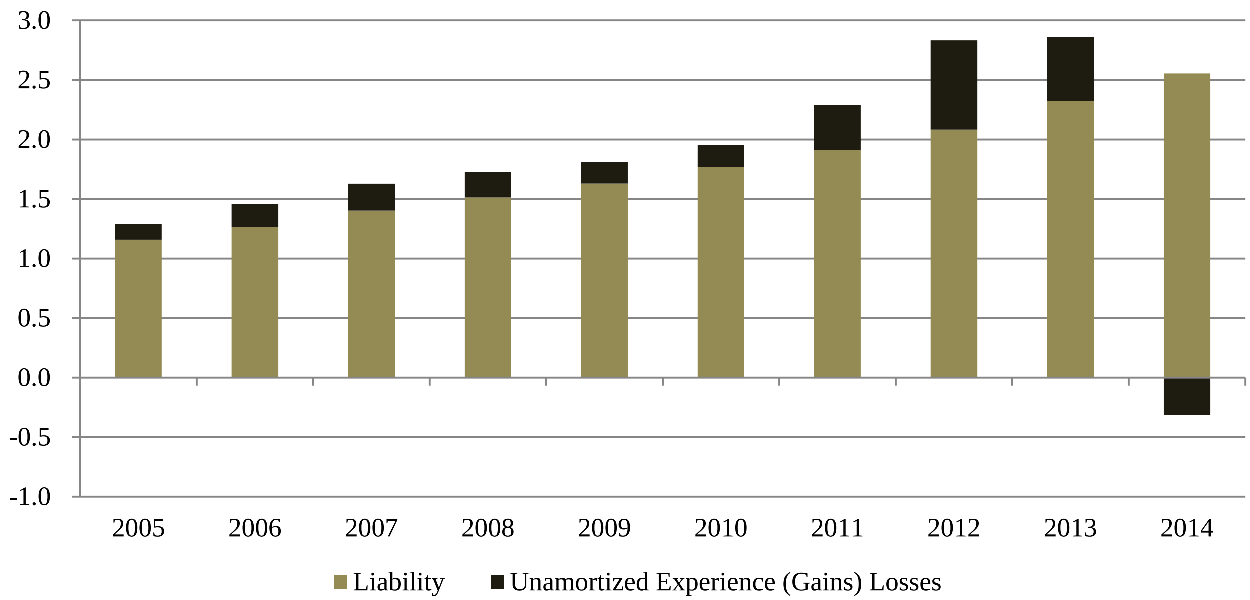
Active and retired public sector employees and Members of the House of Assembly are eligible to participate in group health and life insurance plans. Once an employee retires, the Province continues to cost share these premiums.

As at March 31, 2014, the plans provided benefits to a total of 24,128 retirees. This represents a 7.5% increase in beneficiaries in just one year. Obligations for retirement benefits result from a commitment by Government to provide benefits to employees on retirement in return for their current services. Extended health care and life insurance benefits for retirees are a form of compensation offered for current services rendered by employees and accrue over the years employees work.

Chart 10 shows the components of the group health and life insurance liability for the years ended March 31, 2005 to 2014.

Chart 10

Consolidated Summary Financial Statements
Group Health and Life Insurance Liability Components
Years Ended March 31
($ Billions)

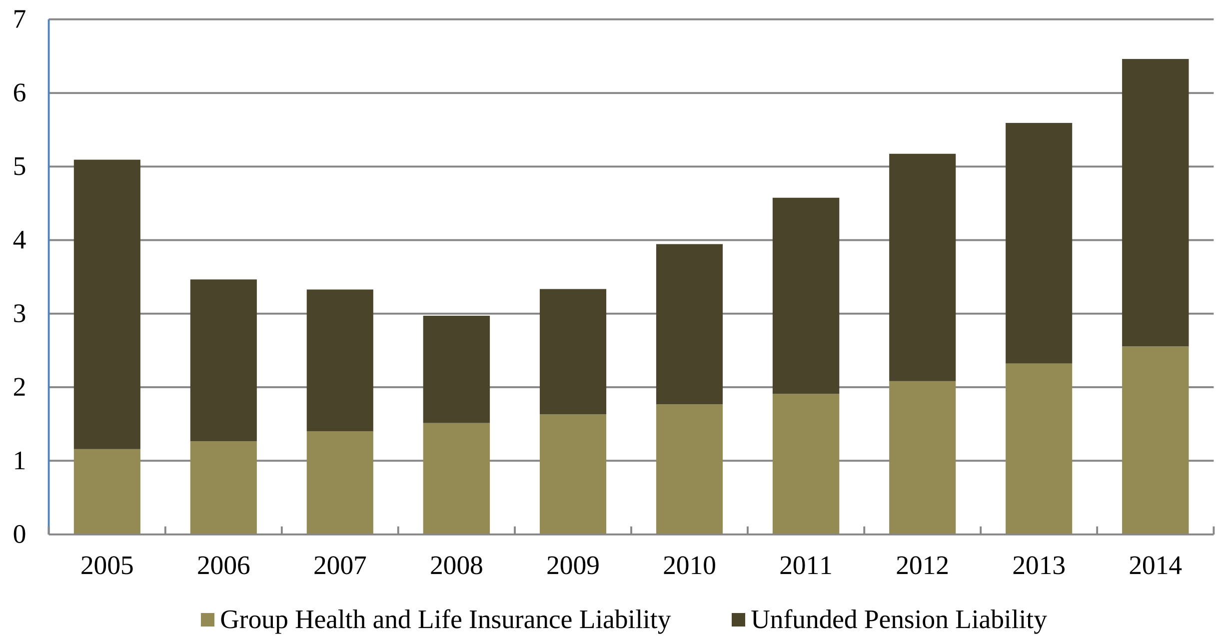


Combined Liability

Chart 11 shows total employee future benefits liability for the years ended March 31, 2005 to 2014.

Chart 11

Consolidated Summary Financial Statements
Employee Future Benefits Liability
Years Ended March 31
($ Billions)



The unfunded liability related to employee future benefits declined significantly in 2005-06, the year the $2 billion advance payment under the Atlantic Accord 2005 was directed to the Teachers' Pension Plan. In addition, further special payments totaling approximately $1.6 billion were made between 2006 and 2014 to address the unfunded pension liability. Since 2007-08, the unfunded liability has increased by 117%, and as a result, at March 31, 2014 the total unfunded liability is now greater than it was at March 31, 2005, despite in excess of $3.6 billion in special payments over that period.

The increase in the unfunded liability for employee future benefits since 2005 was primarily caused by the following factors:

- Market risk associated with the pension fund assets. Pension assets are subject to market risk and were impacted dramatically by the stock market correction that occurred during 2008 and 2009. A significant portion of the Province's additional contributions to the pension assets were offset by the decline in the value of the assets resulting from this market correction. This highlights the inherently volatile nature of this liability. The impact of this market correction is presently being amortized into the liability over the estimated average remaining service life of the active participants of the retirement benefit plans.

- The obligation for group health and life insurance continues to increase each year as employees continue to earn benefits for services rendered. This obligation is not funded. Since 2004-05, the group health and life insurance obligation has increased from $1.2 billion to $2.6 billion - an increase of approximately 117%. The increase results from the increased cost of these plans and the increased number of provincial employees earning benefits.

- The liability for employee future benefits also increases each year because of the interest on the unfunded portion of the liability. Since 2004-05, the obligation has increased by $3.2 billion as a result of interest.

Recent negotiated changes to the Public Service Pension Plan may impact the net unfunded liability, however, the magnitude is uncertain at this time.

Observations

- The net unfunded liability related to employee future benefits (pension plans and other post-retirement benefits) has increased by 117% since 2008.

- Recent negotiated changes to the Public Service Pension Plan may impact the net unfunded liability, however, the magnitude is uncertain at this time.

Unamortized Experience Gains and Losses

The liability for employee future benefits may change because actual experiences are different than those assumed by the actuary or if there are changes to the assumptions used by the actuary. Differences of this nature are referred to as experience gains and losses. Current Public Sector accounting standards require that any experience gains and losses on employee future benefits be amortized over the estimated average remaining service life of the active participants. In other words, the full impact of the experience gains and losses on the liability is recognized over a longer period of time.

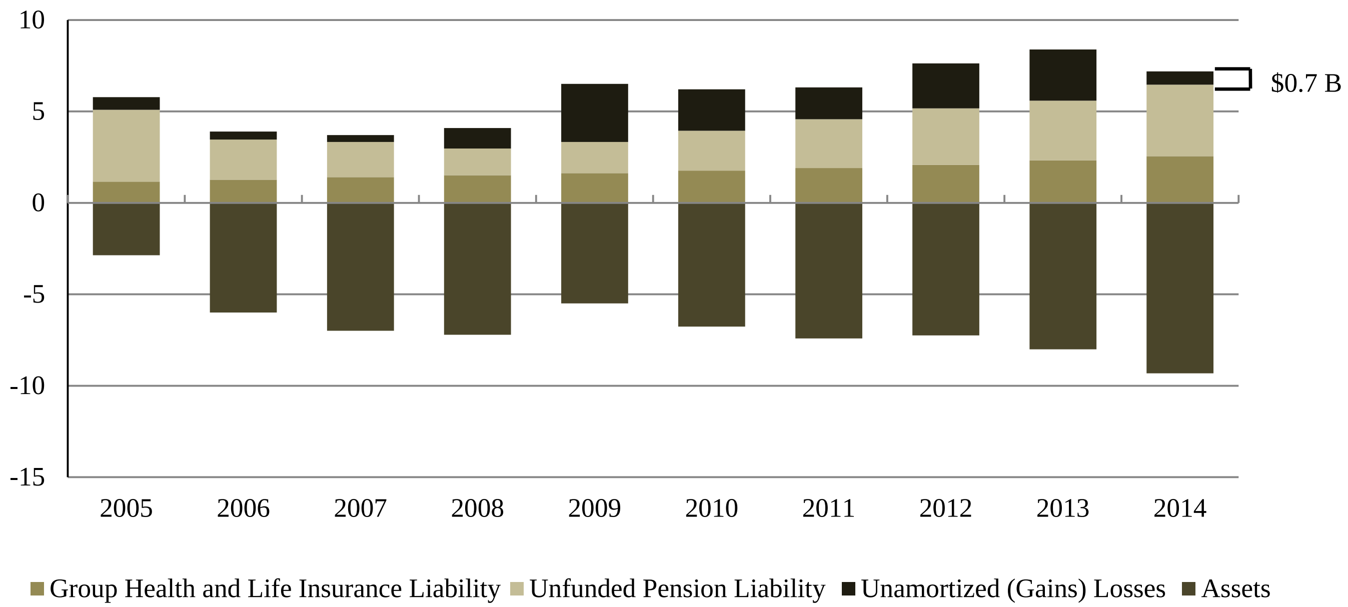
For the pension plans, this presently ranges from 7 to 16 years, depending on the pension plan. The amortization commences in the year subsequent to the year in which the experience gain or loss arose.

For the group health and life insurance benefits liability, this presently ranges from 11 to 13 years, depending on the plan. The amortization commences in the year subsequent to the year in which the experience gain or loss arose.

Chart 12 shows the total employee future benefits liability for the years ended March 31, 2005 through March 31, 2014, including unamortized gains and losses.

Chart 12

Consolidated Summary Financial Statements
Employee Future Benefits Liability, including Unamortized (Gains) Losses
Years Ended March 31
($ Billions)



The unamortized gains and losses on employee future benefits were $0.7 billion for the year ended March 31, 2014, and ranged from $0.4 billion to $3.2 billion during the period March 31, 2005 to March 31, 2014. Without the ability to defer and amortize the experience gains and losses, the employee future benefits liability would be much higher each year. Net Debt would also be higher as a result. For example, for the year ended March 31, 2014, the employee future benefits liability would have been $7.2 billion, instead of $6.5 billion as reported.

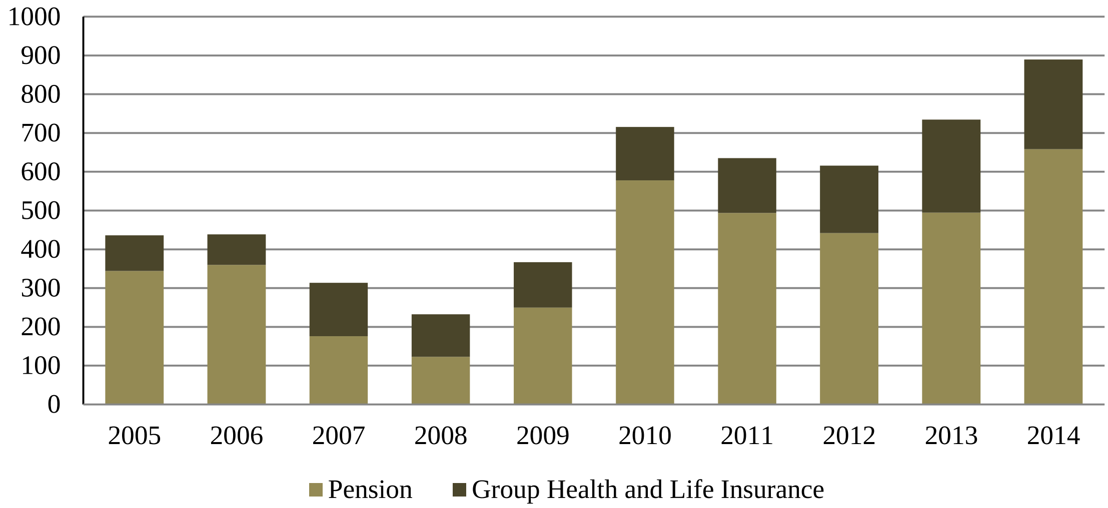
The amortization of these unamortized experience gains and losses of $0.7 billion over the next several years will result in an increase in the unfunded liability for employee future benefits. Furthermore, additional experience gains or losses may occur in the future as previous actuarial assumptions are revised to reflect actual experiences or there are changes to the assumptions used by the actuary. These experience gains or losses will also impact the unfunded liability for employee future benefits.

Employee Future Benefits Expense

Chart 13 shows the employee future benefits expense for the years ended March 31, 2005 to 2014.

Chart 13

Consolidated Summary Financial Statements
Employee Future Benefits Expense
Years Ended March 31
($ Millions)



As Chart 13 indicates employee future benefits expense has increased from $233 million in 2007-08 to $890 million in 2013-14 - an increase of $657 million or 282%.

Observation

- The annual expense recorded by the Province related to employee future benefits (pension plans and other post-retirement benefits) has increased by 282% since 2008.

Observation

- Recent negotiated changes to the Public Service Pension Plan may impact the annual expense, however, the magnitude is uncertain at this time.

Revenues

Significance of Oil Royalties

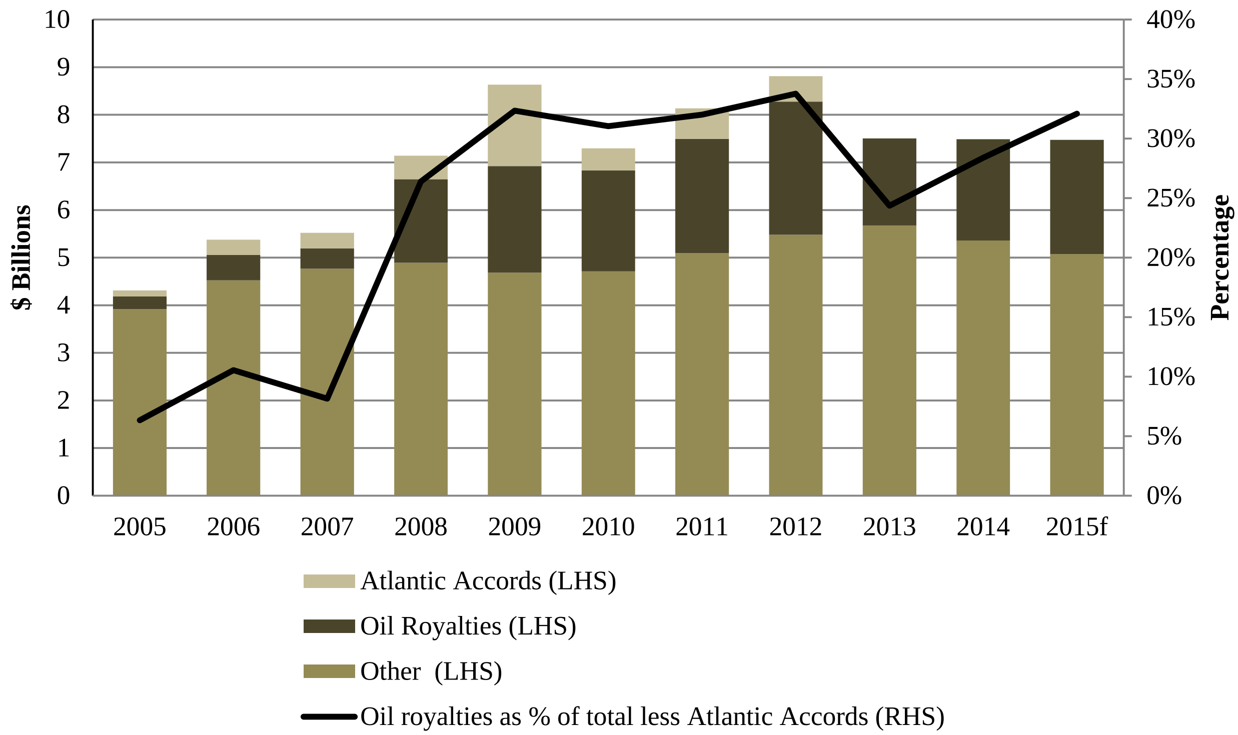
As the significance of the offshore oil sector has impacted the overall economy of Newfoundland and Labrador, there is a corresponding growing reliance by Government on oil royalties to fund its programs and services. This revenue source as a percentage of revenues has increased substantially in recent years. In 2004-05, oil royalties were $265 million, or 6.3% of total revenues, excluding revenues from the Atlantic Accords. In 2013-14, oil royalties were $2.1 billion, or 28.4% of total revenues, an increase of $1.8 billion.

The impact of oil production on the overall revenues of the Province is even greater considering that a significant portion of corporate income tax, personal income tax, and other direct, indirect and induced revenues result from activity in the offshore sector as well.

Chart 15 shows total revenues for the years ended March 31, 2005 to March 31, 2015.

Chart 15

Consolidated Summary Financial Statements
Revenues
Years Ended March 31



Volatility and Predictability

Oil royalties are a volatile source of revenue for Government. The revenue that the Province receives from oil royalties depends on the level of oil production, the price of oil and the Canada-US dollar exchange rate. These factors are all outside the control of Government and are subject to significant variability.

Revenue from oil royalties declined by approximately $1.0 billion from 2011-12 to 2012-13, an indication of the volatility of this revenue source. Meanwhile, oil royalties are only projected to increase by approximately $0.3 billion between 2013-14 and 2014-15. The current softness in oil prices may impact this increase if oil prices continue their current levels further into 2014-15.

Observation

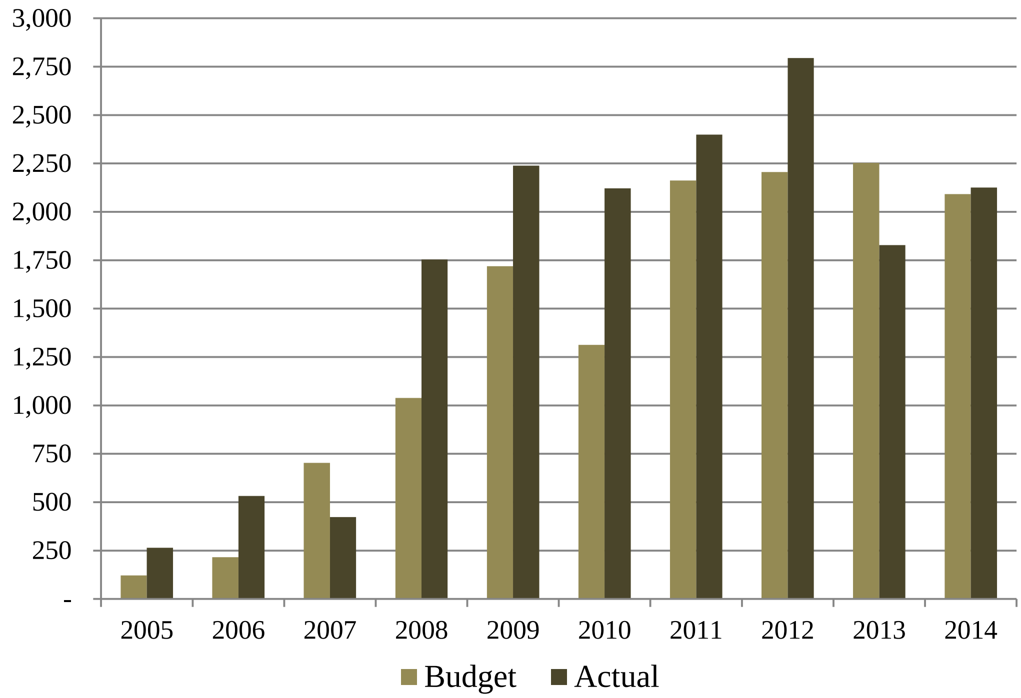
- Oil royalties accounted for 28% of Provincial revenue in 2013-14 and are dependent on factors outside the control of the Government.

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

Chart 16 shows the budget estimate and actual offshore royalties from 2005 to 2014.

Chart 16

Consolidated Summary Financial Statements
Offshore Royalties: Budget and Actual
Years Ended March 31
($ Millions)



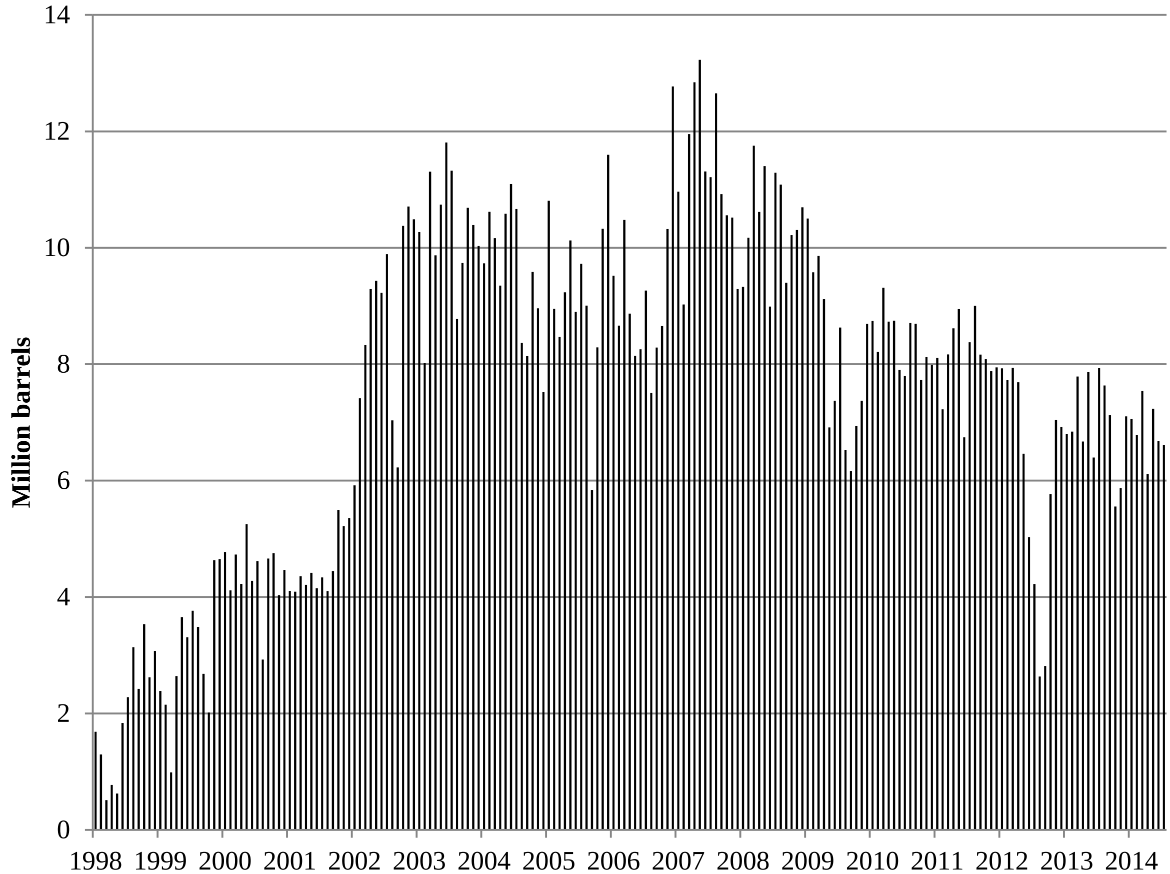
There have been significant differences between budget estimates and actual offshore royalties from 2005 to 2014. Actual revenue from offshore royalties has exceeded the budget estimate for each year since 2005 with the exception of 2007 and 2013.

The difference between budget and actual demonstrates the uncertainty that exists in forecasting revenue from offshore royalties.

Chart 17 shows monthly oil production for the period of January 1998 to July 2014.

Chart 17

Province of Newfoundland and Labrador
Monthly Oil Production
January 1998 to July 2014
(Million barrels)



Source: Canada-Newfoundland and Labrador Offshore Petroleum Board, September, 2014

Monthly oil production is subject to significant variation. While 2012 production levels were impacted by scheduled downtime for maintenance, monthly oil production has shown an overall downward trend since 2007.

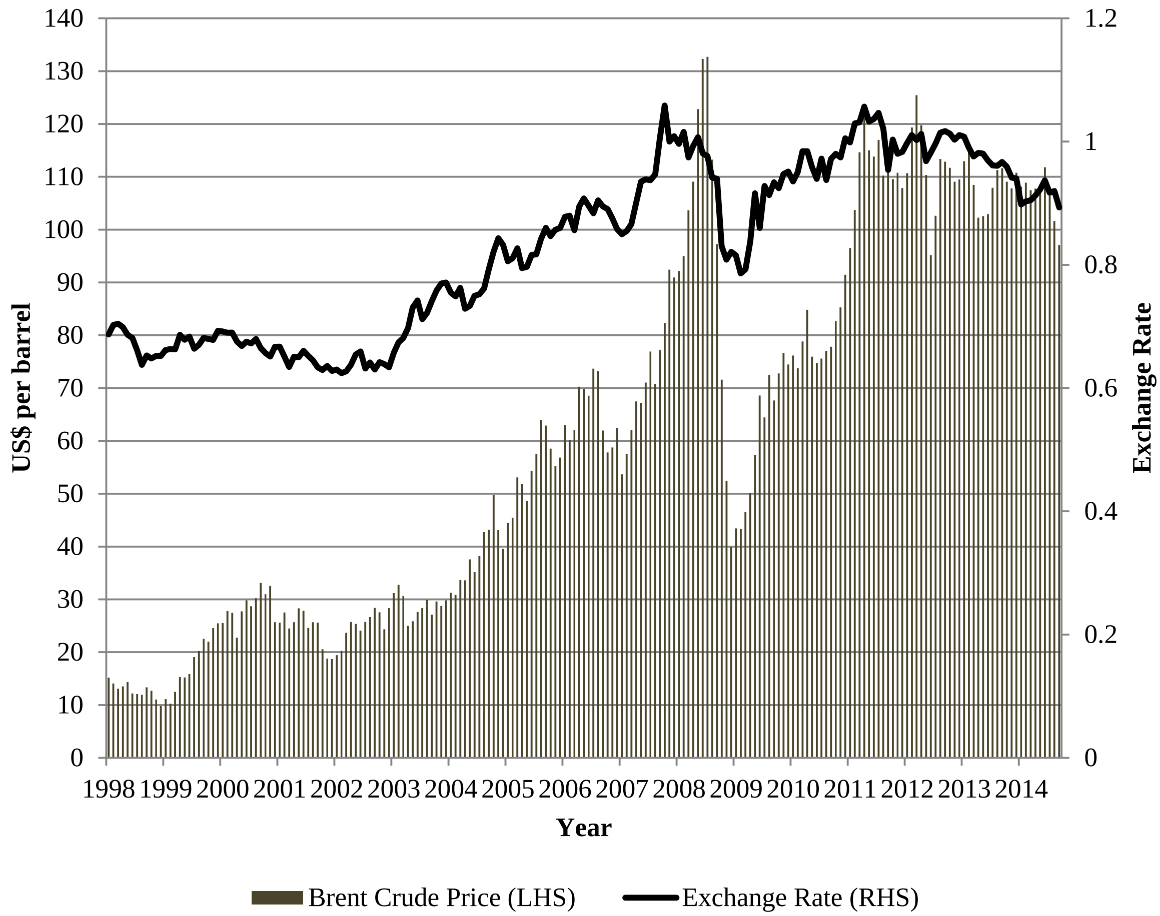
Observation

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

Chart 18 shows the average monthly spot price of Brent Crude and the Canada-US exchange rate from January 1998 to September 2014.

Chart 18

Brent Crude - Average Monthly Spot Price
Canada - US exchange rate
January 1998 to September 2014



Source: US Department of Energy – Energy Information Administration (Brent Crude price)
Statistics Canada; Bank of Canada – (Canada-US Exchange Rate)

There have been significant fluctuations in the price of Brent Crude and the Canada-US exchange rate during this period. The price of Brent Crude had declined to US $86.36 per barrel on October 14, 2014 - the lowest point since 2010.

Observation

- The price of Crude oil fluctuates considerably and on October 14, 2014 had fallen to US $86.36 per barrel, the lowest point since 2010.

Own Source Revenue as a percentage of GDP

The Government of Newfoundland and Labrador receives revenue from two general sources. The first is from within the Province and is referred to as "own source revenue". The second source is transfers from the Federal Government.

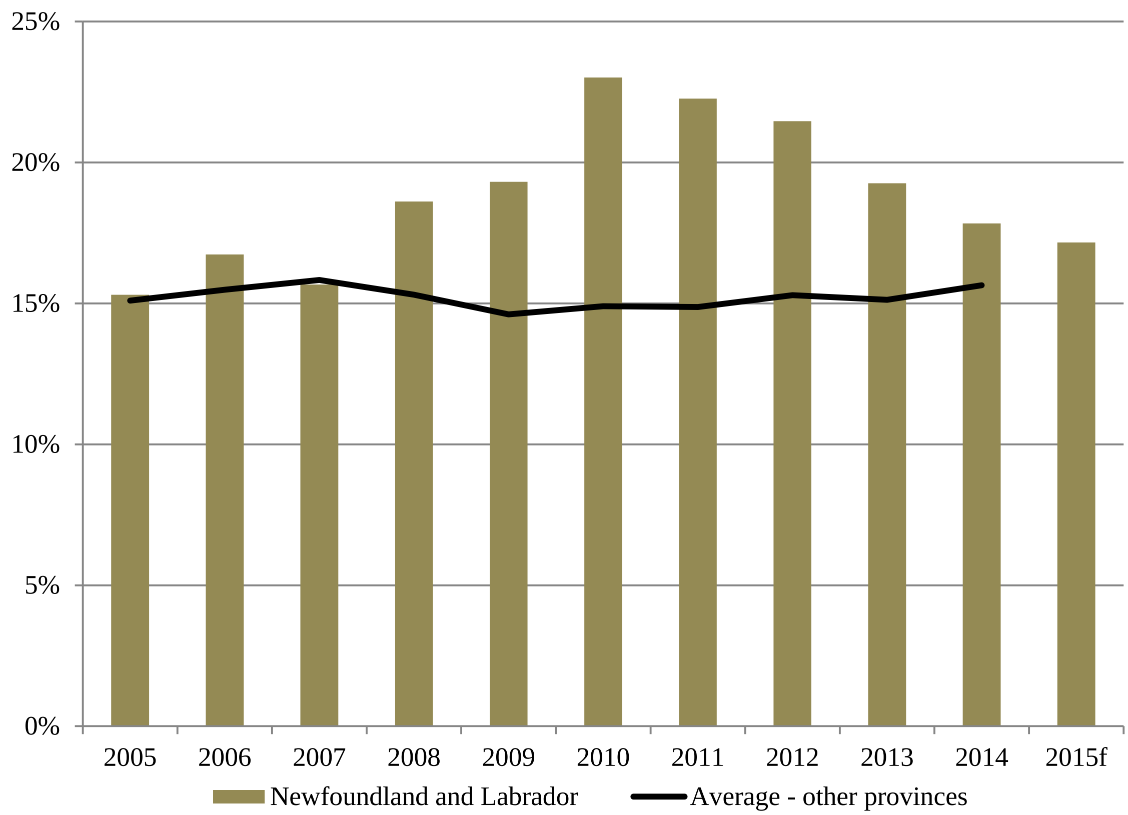
Own source revenue as a percentage of GDP gives an indication of the amount of revenue a government raises from the economy through such items as taxes, fees, and royalties. It provides an indication of the flexibility a government has to increase its financial resources through own source revenues.

The ability of the Province to generate own source revenues in the future depends upon the size and strength of the Provincial economy. Therefore, it is important to consider own source revenue in relation to the Provincial economy.

Chart 19 shows own source revenues as a percentage of GDP from 2005 to 2015.

Chart 19

Consolidated Summary Financial Statements
Own Source Revenue as a Percentage of GDP
Years Ended March 31



Revenue raised from sources within the Province as a percentage of GDP, has increased from 15.3% in 2005 to a high of 23.0% in 2010 and has dropped back to 17.8% in 2014. The Province now generates more income from the economy than it did in 2005, likely a reflection of the strength of the resource sector. Compared to the rest of Canada, it appears the Province may have a greater reliance on the resource sector.

Federal Government revenues compared to total revenues

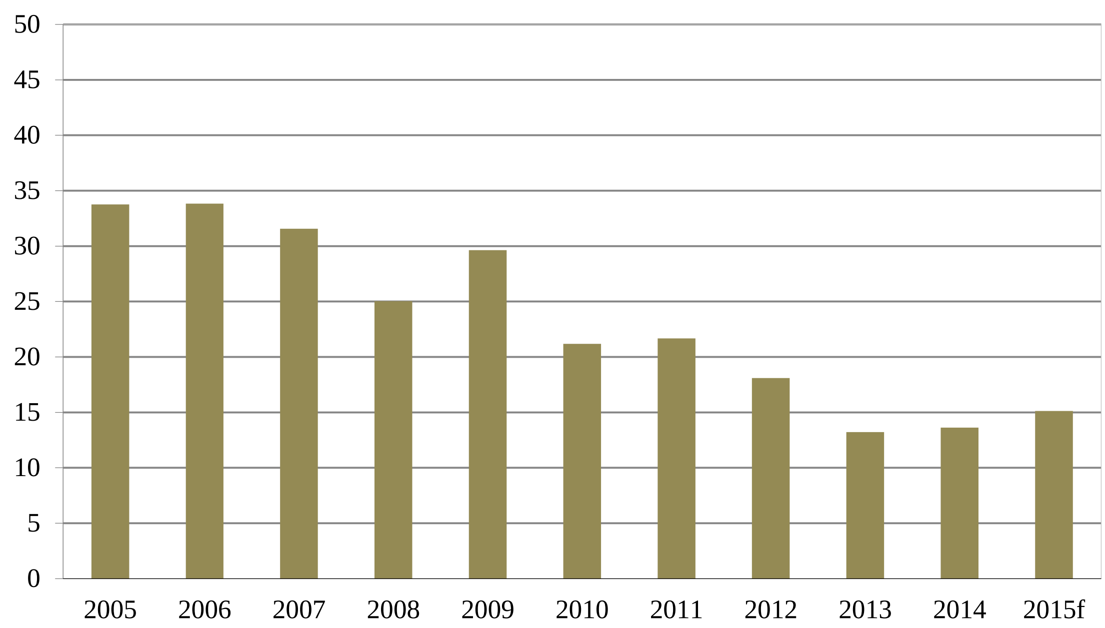
Federal Government revenues compared to total revenues reflects how dependent Government is on transfers from the Federal Government and how vulnerable Government is to changes in these transfers in its ability to finance its programs and services.

A significant portion of Government revenue consists of transfers from the Federal Government such as Health and Social Transfers and cost-shared programs. Newfoundland and Labrador does not currently receive equalization payments and, as such, is considered to be financially self-reliant. Equalization transfers are affected by each province's performance in relation to the performance of other provincial economies, and, therefore, are subject to change. However, given the current operation of the equalization formula, entitlements do not respond, on a timely basis, to changes in economic or financial circumstances.

Chart 20 provides information on the percentage of Federal revenues compared to the Province's total revenues from 2005 to 2015.

Chart 20

Consolidated Summary Financial Statements
Federal Revenues as a Percentage of Total Revenues
Years Ended March 31



Federal revenue as a percentage of total revenue has declined from 33.8% in 2005 to 13.6% in 2014. As Federal revenues have remained relatively constant over the past ten years, the improvement in the measure of Federal revenues as a percentage of total revenues is attributable to increases in own source revenues. The lower the percentage of Federal revenues as a percentage of total revenues, the less potential impact (i.e. the vulnerability) the Province has related to any change in these revenues.

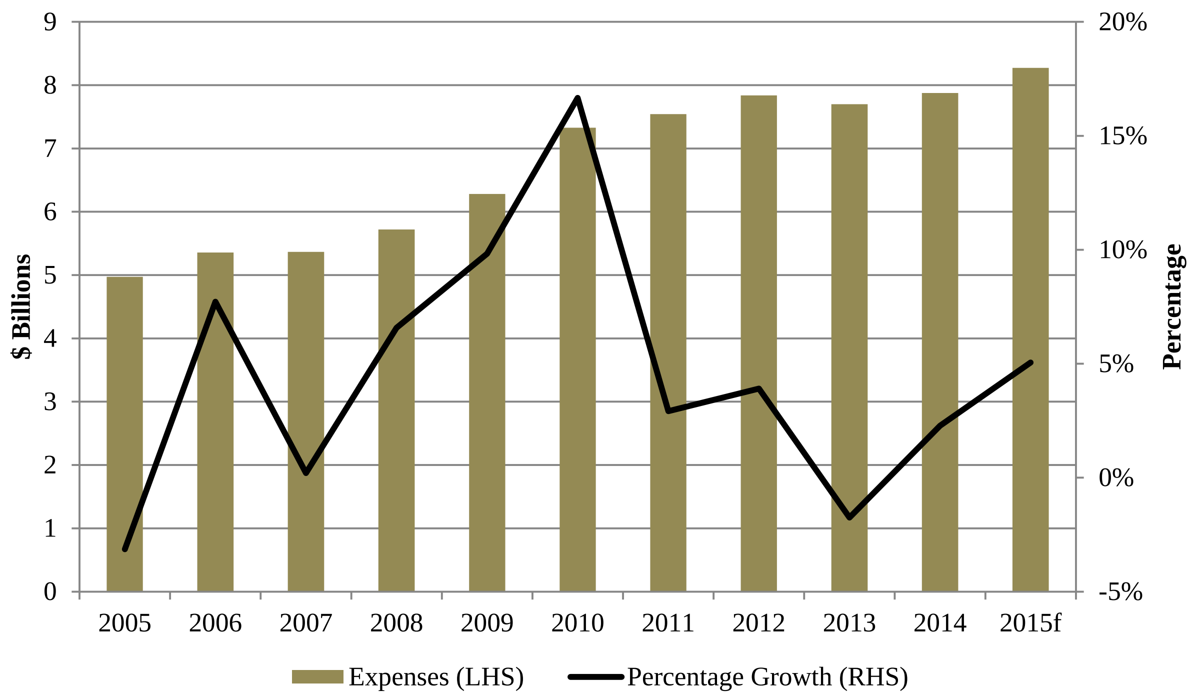
Expenses

For the year ended March 31, 2014, Government recorded a deficit of $389 million, meaning that expenses were at a level that exceeded revenues. The Government is also forecasting a deficit for the year ended March 31, 2015.

Chart 21 shows expenses, and the growth in expenses, for the years ended March 31, 2005 to 2015.

Chart 21

Consolidated Summary Financial Statements
Expenses and growth in expenses
Years Ended March 31



Since 2004-05, expenses have grown from $5.0 billion to $7.9 billion in 2013-14, an increase of $2.9 billion, or 58.0%. Expenses increased by 2.3% in 2014 and are expected to increase by almost 5.1% in 2015 to $8.3 billion based on information contained in Budget 2014.

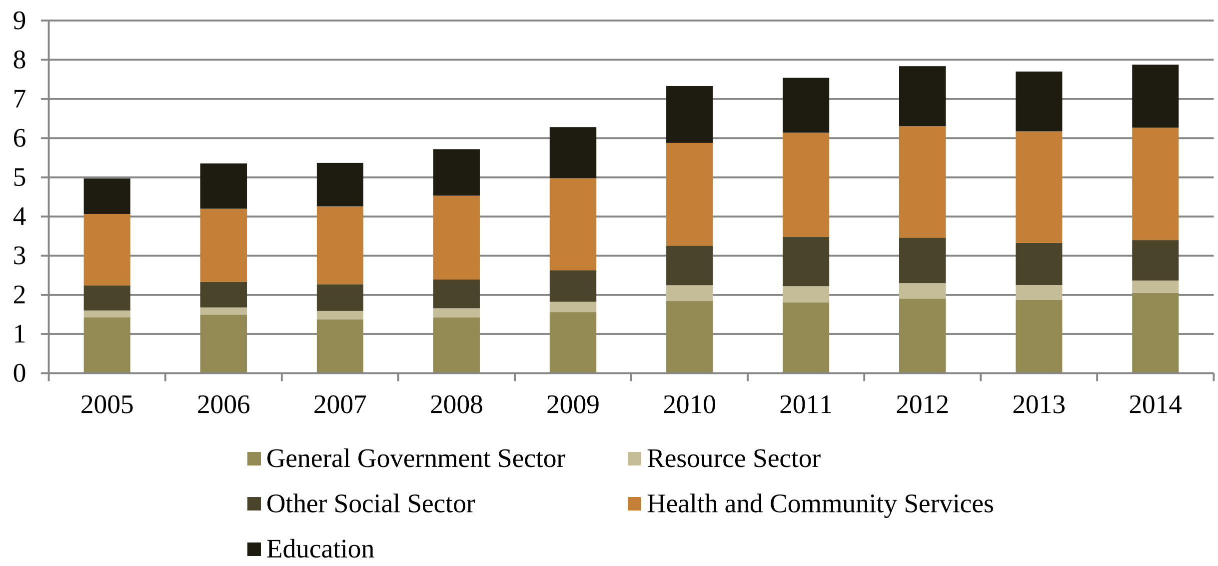
Observation

- Expenses have grown by 58% over the period from 2004-05 to 2013-14.

Chart 22 shows expenses by sector, for the years ended March 31, 2005 to 2014.

Chart 22

Consolidated Summary Financial Statements
Expenses by sector
Years Ended March 31
($ Billions)



Note: During 2011-12, departmental reorganization resulted in certain expenses in the Social Sector being transferred to the Resource Sector. For the purposes of this chart, expenses for the years 2011 through 2014 have been presented in a manner that is consistent with the financial results that were originally published in the Consolidated Summary Financial Statements prior to the occurrence of the departmental restructuring to facilitate comparability.

Since 2005, there has been a significant increase in spending in the Social Sector, where expenses have grown from $3.4 billion to $5.5 billion, an increase of $2.1 billion or 62%. The Social Sector represented 70% of total spending for the year ended March 31, 2014. This growth in spending has occurred primarily in the areas of Health and Community Services and Education.

Spending for the Department of Health and Community Services has increased from $1.8 billion (37% of total expenses) in 2005 to $2.9 billion in 2014 (36% of total expenses). This increase of $1.1 billion represents 38% of the total increase in all expenses of $2.9 billion since 2005.

Spending for the Department of Education has increased from $0.9 billion (18% of total expenses) in 2005 to $1.6 billion in 2014 (20% of total expenses). This increase of $0.7 billion represents 24% of the total increase in all expenses of $2.9 billion since 2005.

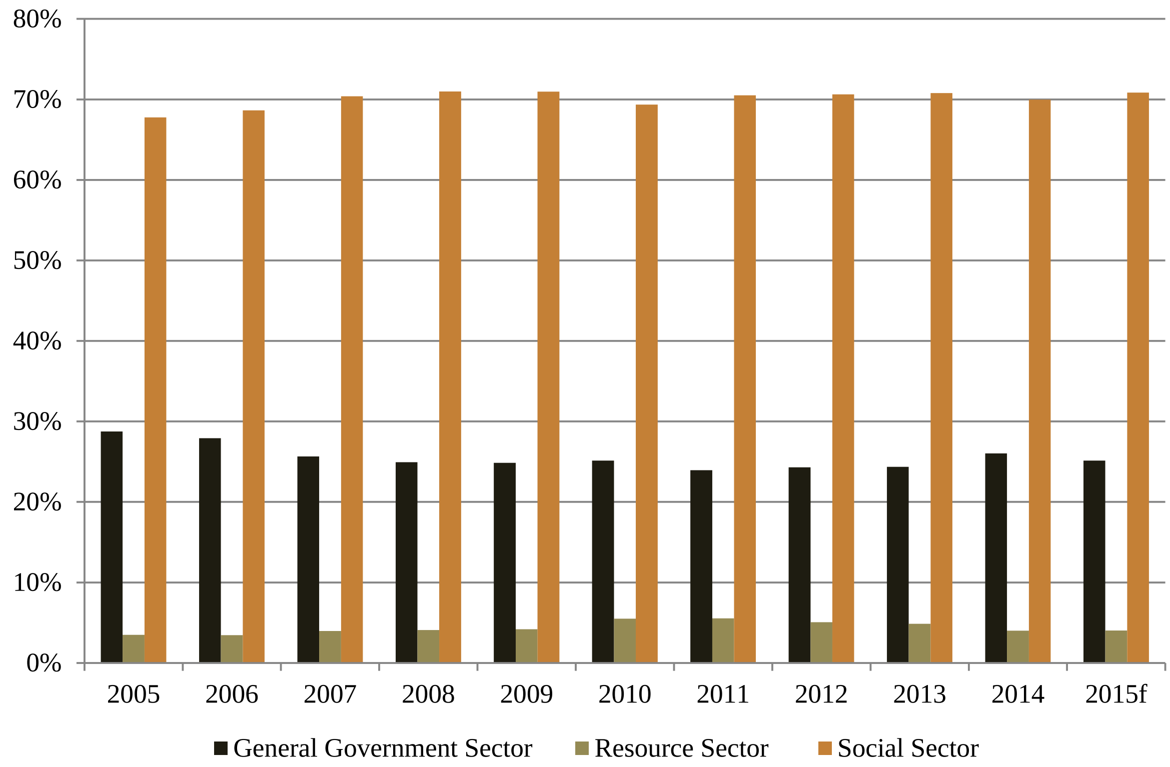
Expenses by sector (function) as a percentage of total expenses

A useful indicator to assess the degree to which a government can maintain existing programs is to examine the trend of government spending in particular functional areas, or sectors, over a period of time. A sector that grows at a much faster rate than total expenses may not be sustainable over the long term. Furthermore, this could impact the sustainability of other sectors or programs.

Chart 23 shows expenses by sector as a percentage of total expenses from 2005 to 2015.

Chart 23

Consolidated Summary Financial Statements
Expenses by Sector as a Percentage of Total Expenses
Years Ended March 31



Note: During 2011-12, departmental reorganization resulted in certain expenses in the Social Sector being transferred to the Resource Sector. For the purposes of this chart, expenses for the years 2011 through 2015f have been presented in a manner that is consistent with the financial results that were originally published in the Consolidated Summary Financial Statements prior to the occurrence of the departmental restructuring to facilitate comparability.

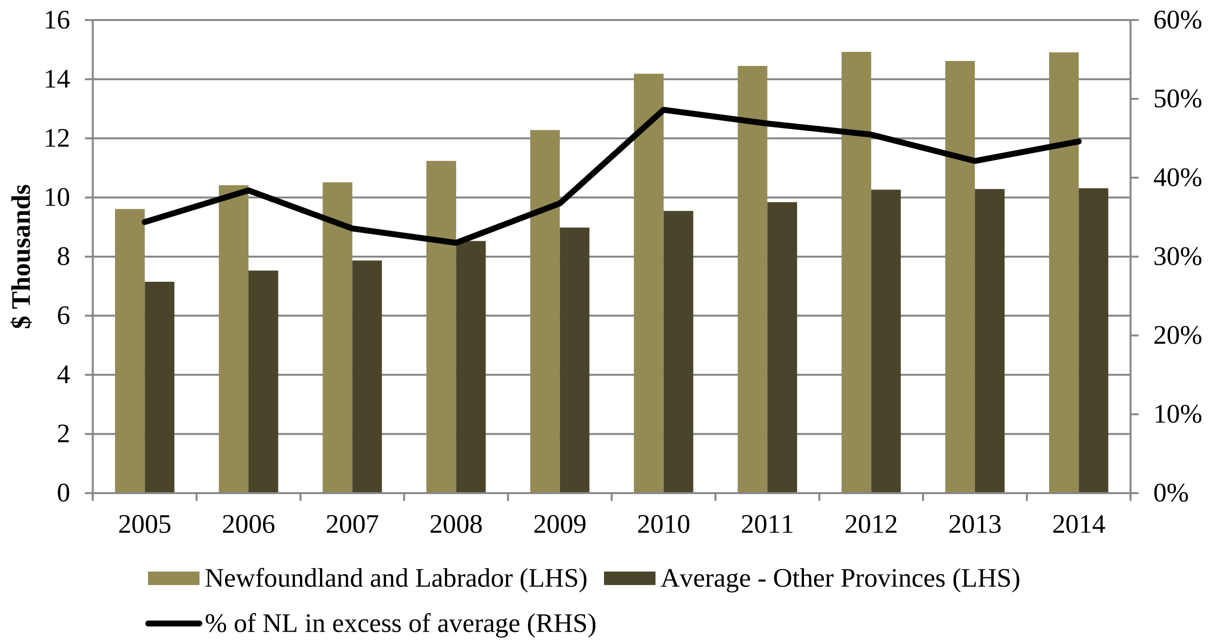
Spending in the Social Sector has been at least 68% of all Government spending for each year since 2004-05 and has grown from 68% to 70% of total Government spending during this time period. Meanwhile, the percentage of Government spending in the Resource Sector has remained relatively constant since 2004-05. The percentage of Government spending in the General Government Sector has declined since 2004-05.

Per Capita Expenses

Chart 24 shows the Province's per capita expenses for the years ended March 31, 2005 to 2014, together with a comparison of these per capita expenses to the average of other provinces in Canada.

Chart 24

Province of Newfoundland and Labrador
Per capita expenses compared to the average of other provinces
Years Ended March 31



Source: Public Accounts - all provinces; Statistics Canada

Observation

- Per capita expenses in Newfoundland and Labrador are the highest in Canada. Furthermore, our per capita expenses are approximately 45% higher than the average of other provinces.

Certain factors would contribute to the Newfoundland and Labrador per capita expenses being higher than those of other provinces. For example, the Government has to provide services to a relatively small population that is disbursed over a large geographical area. The appropriate level of expenses will have to balance factors such as need and affordability.

Reducing per capita expense in Newfoundland and Labrador to the average of other provinces would require a reduction of expenditure levels of $2.43 billion.

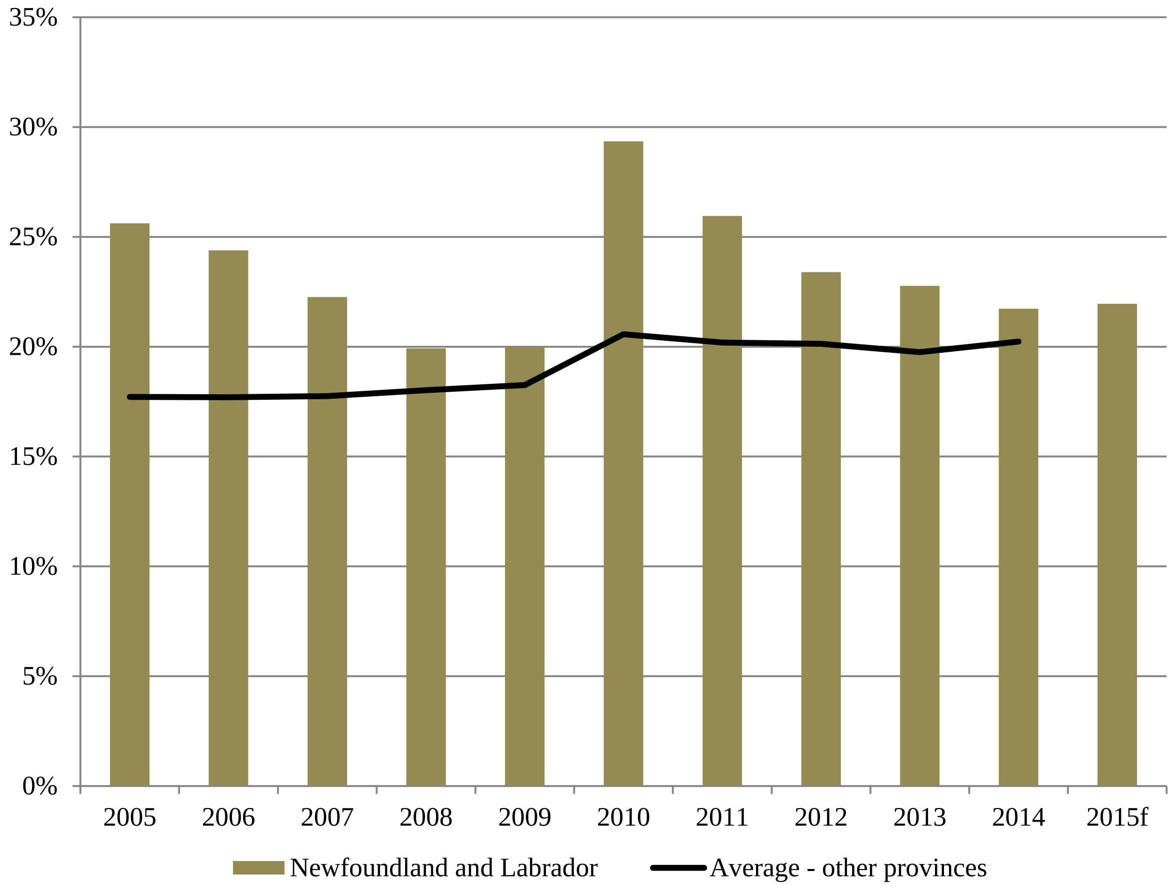
Expenses as a percentage of GDP

Comparing expenses to GDP provides an indication of the trend of provincial spending over time in relation to the growth in the economy. A trend that shows expenses as a percentage of GDP rising may not be sustainable.

Chart 25 shows expenses as a percentage of GDP from 2005 to 2015.

Chart 25

Consolidated Summary Financial Statements
Expenses as a Percentage of GDP
Years Ended March 31



The Province's expenses as a percentage of GDP have declined since 2010, but are still higher than they were in 2008 - which was the lowest point since 2005. In addition, expenses as a percentage of GDP in Newfoundland and Labrador are higher than other provinces.

Interest costs as a percentage of revenue

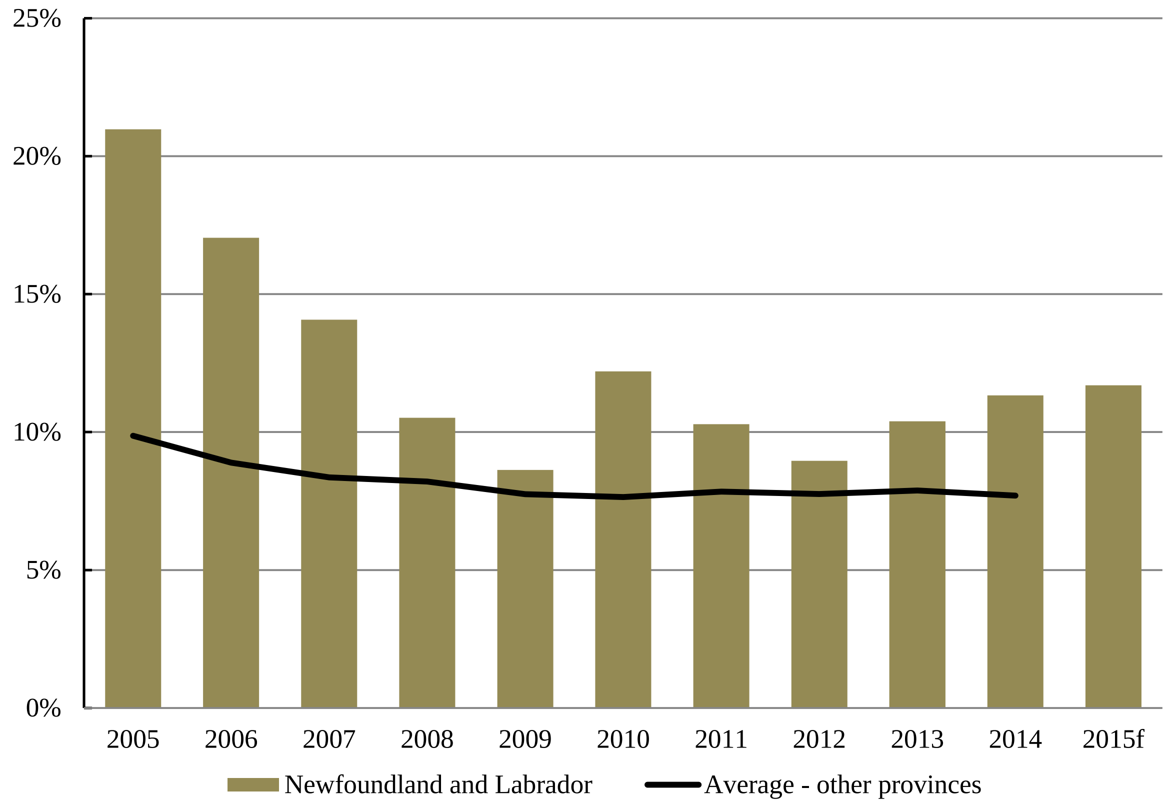
Government incurs interest costs on its borrowings, as well as on its liabilities relating to employee future benefits. At March 31, 2014, Government's long-term borrowings, net of sinking funds, were $5.1 billion, its unfunded pension liability was $3.9 billion and its unfunded group health and life insurance retirement benefits liability was $2.6 billion. In 2014, interest costs (debt expenses) related to these obligations totaled $851 million. The significance of debt expenses is that this money is not available to fund programs and services.

Interest costs as a percentage of revenue, sometimes called the "interest bite", is an important indicator of the state of government finances.

Chart 26 provides the debt expenses as a percentage of revenue for the years 2005 to 2015.

Chart 26

Consolidated Summary Financial Statements
Debt Expenses as a Percentage of Revenue
Years Ended March 31



Debt expenses as a percentage of revenue has declined overall since 2005. However, debt expenses as a percentage of revenue have started to increase once again. These costs continue to be a substantial burden for Government. For example, if expenses as a percentage of revenue were reduced from the current level of 11.4% to the average of other provinces, this would result in an annual saving of approximately $275 million.

Observation

- Debt expenses as a percent of revenue has started to rise again and are higher than the average of all other provinces.

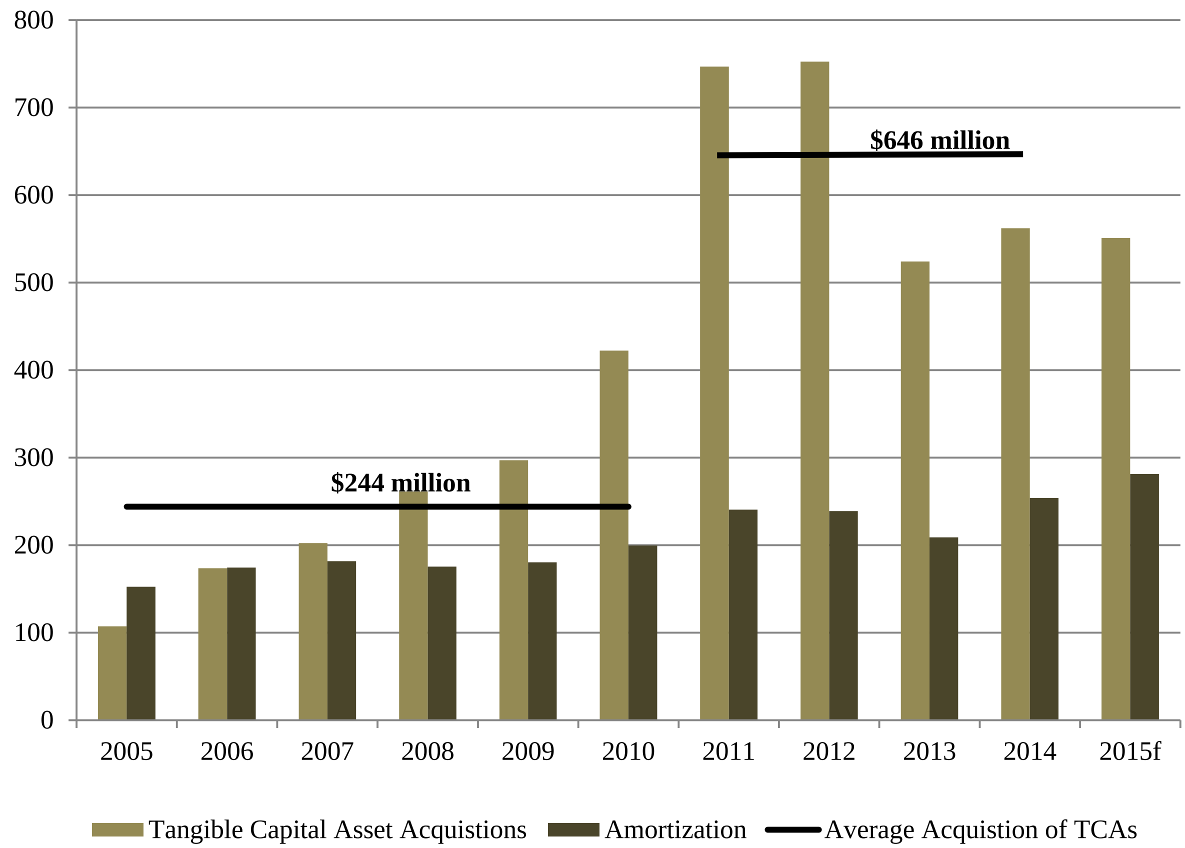
Tangible Capital Assets

Tangible capital assets generally relate to the physical infrastructure of the Province and include roads, buildings and major equipment. A tangible capital asset has a useful life that extends beyond one year. The acquisition is recorded as an asset of the Province in the year acquired and the cost is amortized (recorded as an expense) over the life of the asset.

Chart 27 outlines the acquisition of tangible capital assets (TCAs) and the related amortization for the years ended March 31, 2005 to 2015.

Chart 27

Consolidated Summary Financial Statements
Tangible Capital Asset Acquisition and Related Amortization
Years Ended March 31
($ Millions)



Government has increased capital spending dramatically in recent years. From 2005 to 2014, the Province spent a total of $4.0 billion related to tangible capital assets. Acquisitions of tangible capital assets from 2011 to 2014 averaged approximately $646 million – more than 2 times greater than the average annual spending on tangible capital assets from 2005 to 2010 - which was $244 million.

Observation

- Provincial spending on infrastructure has averaged $646 million over the past four years – an increase of $402 million from the average of the six years previously.

The acquisition of tangible capital assets may be seen as a means to provide better services and reduce future expenditures. However, the acquisition of tangible capital assets increases Net Debt as the tangible capital assets have to be acquired through either the use of financial assets or the assumption of additional liabilities.

During the next three years, Government expects to incur a net cumulative deficit from its operations, which will increase Net Debt. The acquisition of tangible capital assets also increases Net Debt. Therefore, Government will need to carefully consider whether the level of tangible capital asset acquisitions that has occurred in recent years is sustainable in the future.

In addition, Government has established a target of having Net Debt per capita equal the average of all other provinces within 10 years. Government will also need to consider the impact that a significant level of tangible capital asset acquisitions on an annual basis combined with potential deficits will have on the achievement of this target.

Observations

- Given that a deficit is forecast for 2014-15 and there is risk of deficits in the near term beyond, Government will need to carefully consider whether the level of tangible capital asset acquisitions that has occurred in recent years is sustainable in the future.

- Government will also need to consider the impact that a significant level of tangible capital asset acquisitions on an annual basis combined with potential deficits will have on the achievement of its target of having Net Debt per capita equal the average of all other provinces within 10 years.

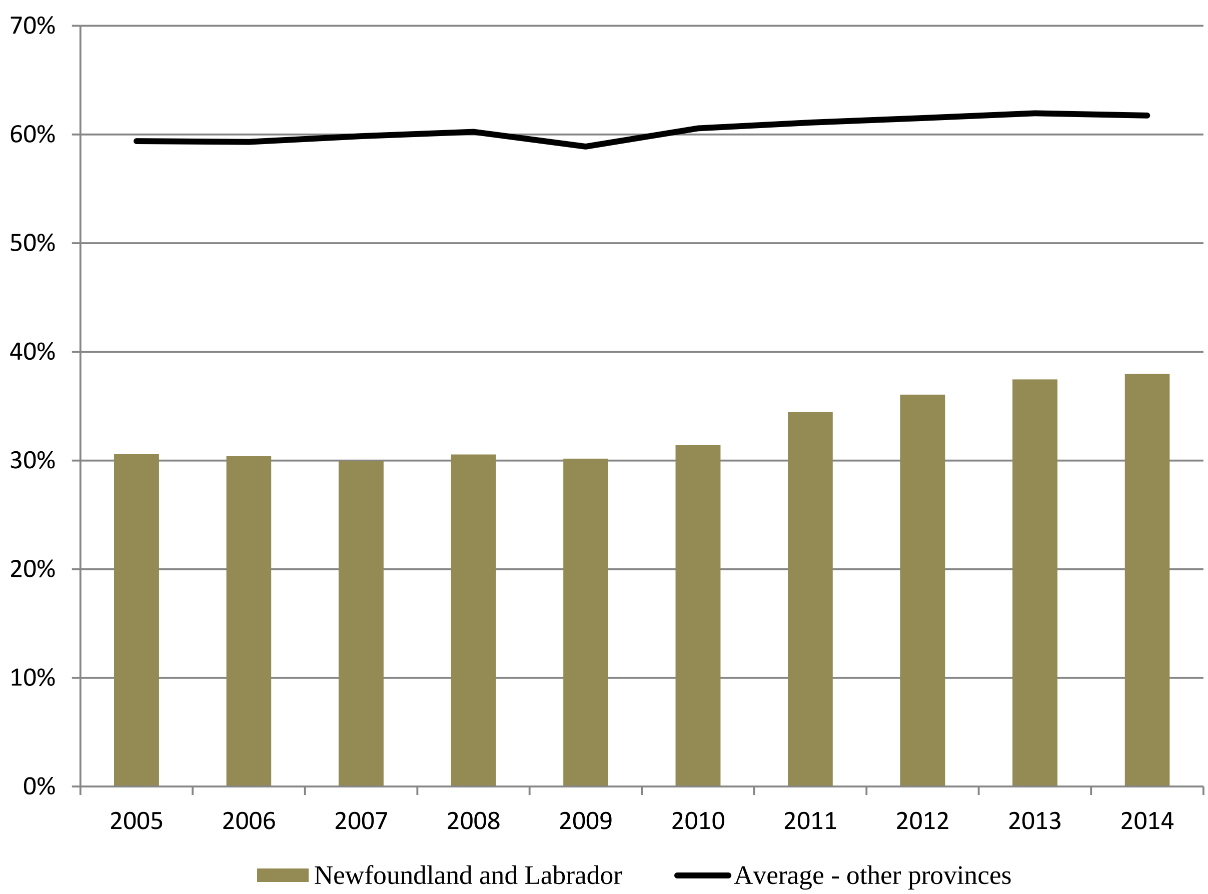
Net Book Value of Tangible Capital Assets to the Cost of Tangible Capital Assets

The net book value of tangible capital assets as a percentage of cost of tangible capital assets measures the extent to which the estimated useful lives of the Province's tangible capital assets are available to provide services to the public. A lower percentage indicates that the Province's tangible capital assets have less remaining useful lives available. If the tangible capital assets have less remaining useful lives available, the Province may have less flexibility when providing services in the future because of the need to spend more of its resources on the repair or replacement of tangible capital assets.

Chart 28 shows the ratio of the net book value of tangible capital assets to the cost of tangible capital assets for 2005 to 2013.

Chart 28

Consolidated Summary Financial Statements
Ratio of the Net Book Value of Tangible Capital Assets to the Cost of Tangible Capital Assets
Years Ended March 31



The net book value of tangible capital assets as a percentage of cost of tangible capital assets has averaged approximately 30% from 2005 to 2009. Since 2009, the percentage has increased from 30% to 38%, which can be attributed to the investment in tangible capital assets since that time.

Chart 28 also indicates that, relative to other jurisdictions in Canada, Newfoundland and Labrador infrastructure is considerably older, an indication of future need.

Observation

- Relative to other jurisdictions in Canada, infrastructure in Newfoundland and Labrador is older – an indicator of future spending pressure.

The acquisition of tangible capital assets may be seen as a means to provide better services and reduce future expenditures. However, Government needs to consider the impact that tangible capital asset acquisitions have on the Province's Net Debt and maintain acquisitions at a level which is sustainable over the long term.

Demographics

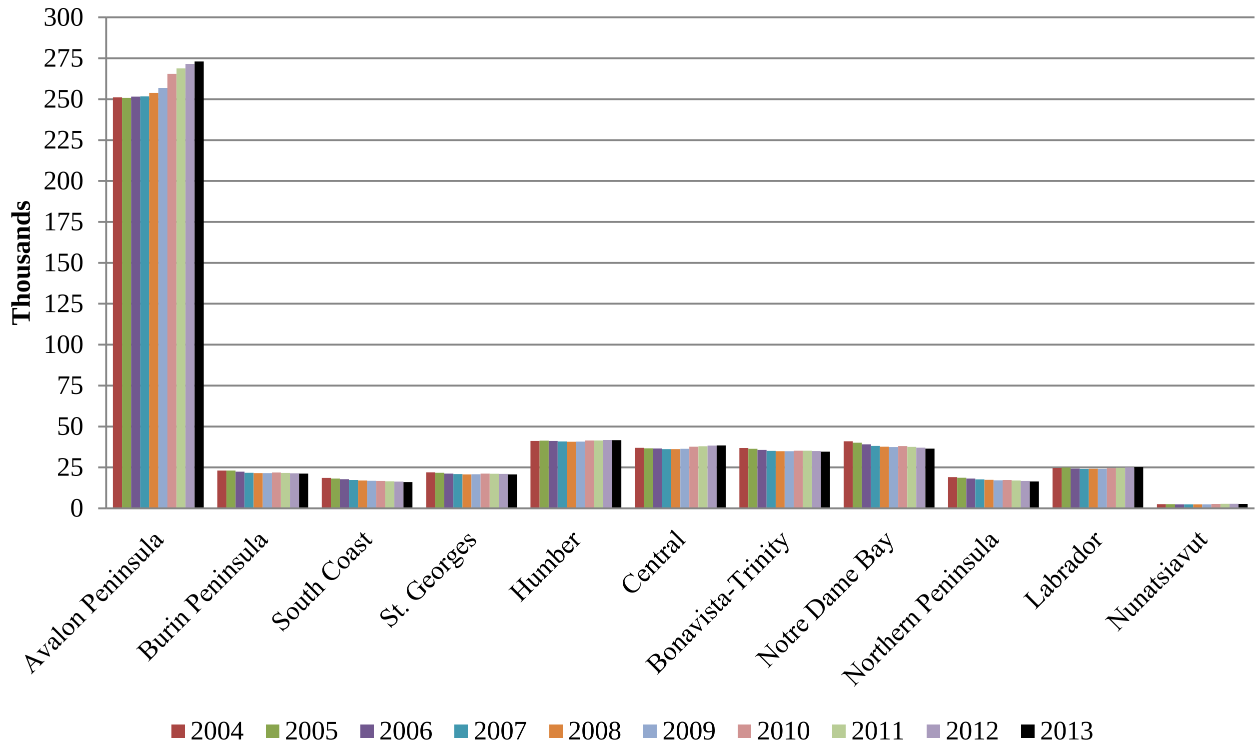
Demographic change is one of the most significant factors which will affect future demands for public services and the delivery of those services. Demographic issues have impacted the revenues and expenses of the Province in previous years and will continue to do so in the future. Demographic issues include shifts in the population between various regions within the Province and an aging population. Such issues will impact service delivery, the types of services required and the associated costs. Demographic change will also have a significant impact on labour markets.

Population

From 2004 to 2013, the population of Newfoundland and Labrador has increased from 517,036 to 526,602. Chart 29 shows the population of the Province by region for the years 2004 to 2013.

Chart 29

Province of Newfoundland and Labrador
Population by Region
2004 - 2013



Source: Statistics Canada

During this time period, the population of the Avalon Peninsula region, which includes the St. John's region, increased from 251,119 to 273,091. Meanwhile, during this time period the populations for other regions of the Province, all of which had populations under 50,000, generally declined. This is likely the result of individuals moving to the Avalon Peninsula region, from either within the Province or outside of the Province, to pursue educational or employment opportunities or leaving the Province altogether.

Population shifts between various regions of the Province can create significant challenges for Government and have to be given serious consideration when determining how to deliver public services in a cost effective and efficient manner. This is particularly important when planning for the development of infrastructure including roads and health care and education facilities. Government may find it increasingly challenging to maintain the delivery of public services, such as education, in regions where there are declining populations. This is in contrast to other regions where Government may struggle to keep up with the demands for education services that are created by increasing populations.

Observation

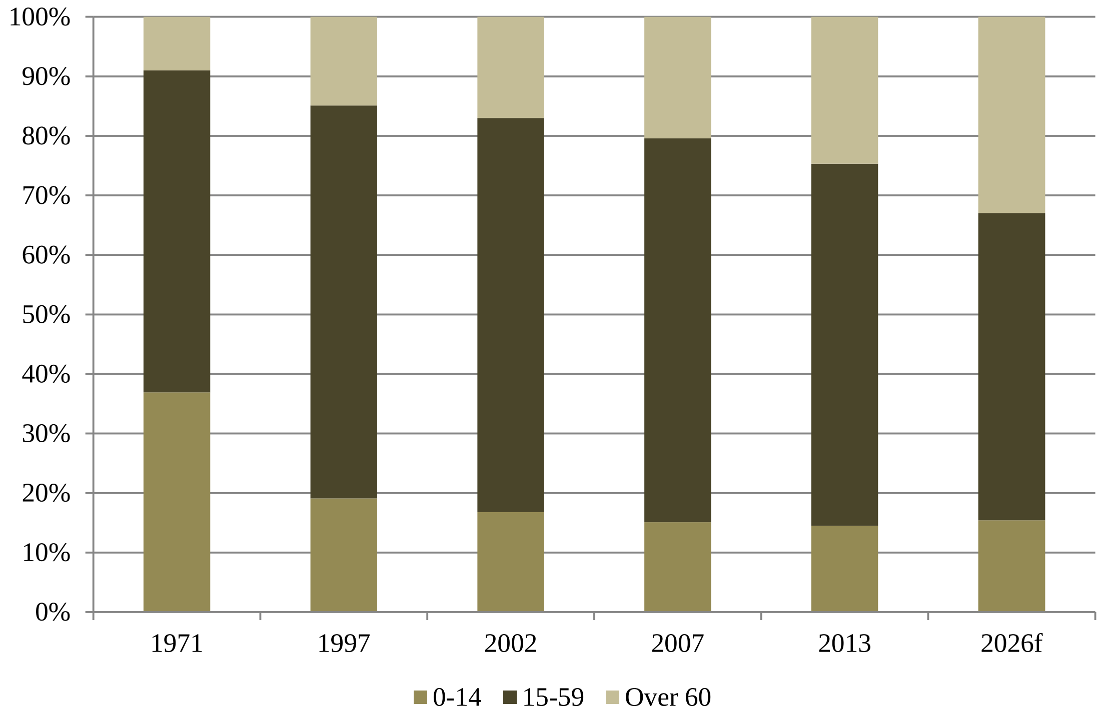
- Population shifts may create challenges for the delivery of public services.

Aging population

Chart 30 shows the percent of population by age cohort for 1971, 1997, 2002, 2007, 2013, and 2026.

Chart 30

Province of Newfoundland and Labrador
Percent of Population by Age Cohort
1971, 1997, 2002, 2007, 2013, 2026



Source: Statistics Canada, Newfoundland and Labrador Statistics Agency

The population of Newfoundland and Labrador is getting older. In 1971, the percentage of the population that was 60 years of age or older was 9%, while in 2013, 25% of the population is 60 years of age or older. Meanwhile, the percentage of the population that is under 15 years of age has declined from 37% in 1971 to 14% in 2013. Furthermore, in 2026 it is forecasted that 33% of the population will be 60 years of age or older, while 15% of the population will be under 15 years of age.

An aging population will create significant challenges for Government and has to be given serious consideration when determining how to deliver public services in a cost effective and efficient manner and in prioritizing expenditures. As the population ages, there will be an increased demand for certain public services such as health care and seniors' housing.

Health care spending is highly correlated to the age of the population. As the population ages, there will be an increase in the prevalence of chronic diseases such as heart disease, cancer, diabetes and arthritis, which will result in higher demands on health care in the future.

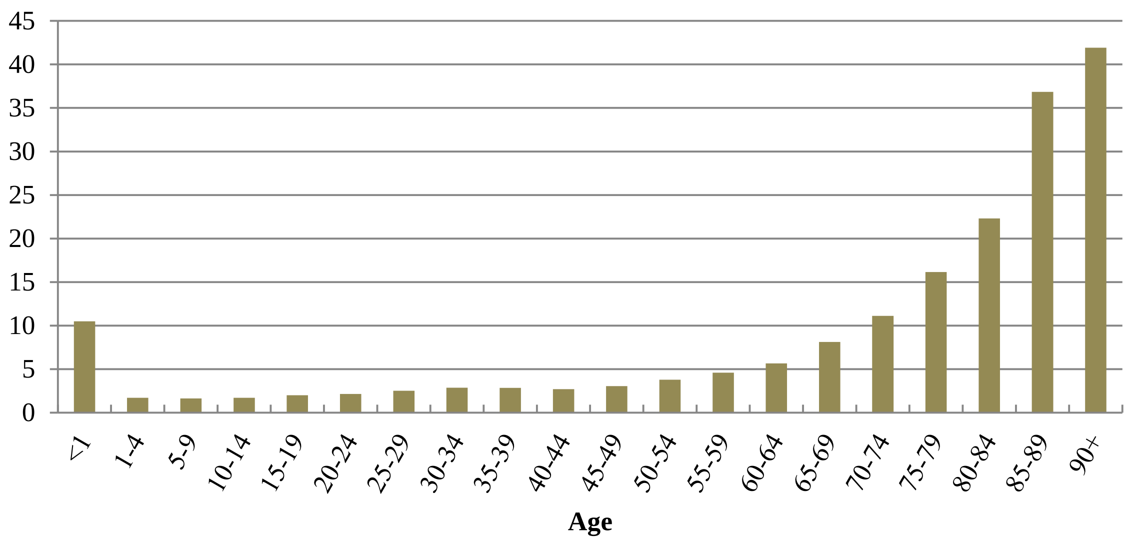
Observation

- An aging population will create challenges for the delivery of public services.

Chart 31 shows the expenditures per capita on health care in the Province by age group for 2011.

Chart 31

Province of Newfoundland and Labrador
Per Capita Health Care Expenditures by Age Group
2011
($000s)



Sources: National Health Expenditure Database, Canadian Institute for Health Information; Statistics Canada

In addition, aging of the population will likely be more prevalent in certain regions of the Province, as younger people move to larger centers to pursue educational or employment opportunities. This may have significant implications for long term planning of regional health care facilities and service delivery models.

However, the demand for other public services such as education, on an overall basis, will decline has the population ages. As in cases where the demand for a public service is increasing, decreases in the demand for a public service also has implications for long term planning related to the delivery of the service.

An aging population is also expected to impact labour markets in the Province. As older people leave the labour force there will be fewer younger people available to enter the labour force, potentially resulting in labour shortages. This situation would be most prevalent in regions of the Province where the population is generally older and may impact certain employment categories more than others. These potential labour shortages would be addressed by individuals staying in the labour force longer or increased in-migration and will likely result in higher labour costs.

Observation

- An aging population will impact labour markets in the Province.

APPENDIX

I

ANSWERS TO FREQUENTLY ASKED QUESTIONS ABOUT THE PUBLIC ACCOUNTS

What are the Public Accounts?

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

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

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

Why are they prepared?

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

What are the Public Accounts "Volumes"?

The Public Accounts for the year ended March 31, 2014, are published in two volumes:

Volume I - Consolidated Summary Financial Statements

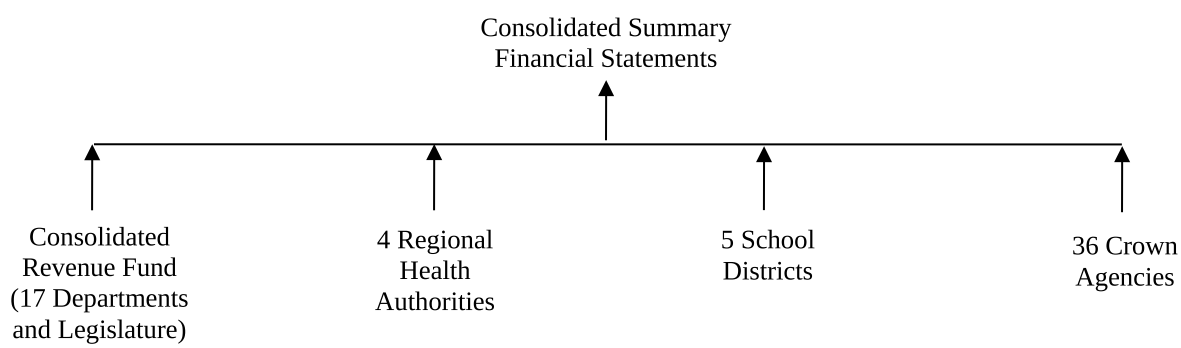
This Volume presents the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador. The Consolidated Summary Financial Statements are prepared on the accrual basis of accounting in accordance with the accounting standards (*i.e.;* Canadian Public Sector Accounting Standards)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

Information contained in this Volume provides the most complete information about the operating results and financial position of the Province and combines the financial activities of the Consolidated Revenue Fund (which accounts for the financial activities of the 17 Government departments and the Legislature) and the various Crown corporations, boards and authorities which are controlled by and therefore accountable to the Government of Newfoundland and Labrador. Government departments and Crown agencies are accountable for the administration of their financial affairs and resources through a Minister.

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

Chart 1

Entities included in the Consolidated Summary Financial Statements
March 31, 2014



As Chart 1 shows, the Consolidated Summary Financial Statements include the financial activities of the Consolidated Revenue Fund as well as 45 other entities (4 regional health authorities, 5 school districts and 36 Crown agencies).

Volume II - Consolidated Revenue Fund Financial Statements

This Volume provides information about the operating results and financial position of the Consolidated Revenue Fund only, comprised of the 17 Government departments and the Legislature. These statements are also prepared on an accrual basis of accounting.

What Statements are included and what do they show?

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

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

Consolidated Statement of Financial Position

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

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

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

Consolidated Statement of Change in Net Debt

This statement reflects the change in Net Debt for the year, calculated as the annual surplus or deficit, any changes in the net book value of tangible capital assets and any changes in other non-financial assets.

Consolidated Statement of Operations

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

Consolidated Statement of Change in Accumulated Deficit

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

Consolidated Statement of Cash Flows

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

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

What accounting policies does Government follow?

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

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

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

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

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

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

Who audits the Public Accounts?

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

Why are they audited?

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

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

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

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

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

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

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

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APPENDIX
II
GLOSSARY

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

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