REPORT OF THE AUDITOR GENERAL

To the House of Assembly

On the Audit of the Financial Statements of the Province of Newfoundland and Labrador

For the Year Ended
31 March 2008

Auditor General of Newfoundland and Labrador

Location: 2nd Floor
15 Dundee Avenue
Mount Pearl, NL

Mail: P.O. Box 8700
St. John's, NL
A1B 4J6

Telephone: (709) 729-2695
Fax: (709) 729-5970
E-Mail: auditorgeneral@gov.nl.ca
Web: www.gov.nl.ca/ag

Mission Statement

The Office of the Auditor General serves the House of Assembly by providing independent examinations of Government and it entities.

As legislative auditors, we audit financial statements and other accountability documents, evaluate management practices and control systems, and determine compliance with legislative and other authorities.

Our purpose is to promote accountability and encourage positive change in the stewardship, management and use of public resources.

Office of the Auditor General of Newfoundland and Labrador

Head Office
15 Dundee Ave., Mount Pearl
Box 8700 ♦ St. John's, NL ♦ A1B 4J6
T: 709-729-2695 ♦ F: 709-729-5970
Email: adgopp@gov.nl.ca

Auditor General
John L. Noseworthy, CA
T: 709-729-2700
Email: jnoseworthy@gov.nl.ca

Regional Office
1 Union St., Corner Brook
Box 2006 ♦ Corner Brook, NL ♦ A2H 6J8
T: 709-637-2295 ♦ F: 709-637-2595

30 January 2009

The Honourable Roger Fitzgerald, M.H.A.
Speaker
House of Assembly

Dear Sir:

In compliance with the *Auditor General Act*, I have the honour to submit herewith, for transmission to the House of Assembly, my Report on the Audit of the Financial Statements of the Province for the year ended 31 March 2008.

Respectfully submitted,

JOHN L. NOSEWORTHY, CA
Auditor General

Foreword

I am pleased to submit my report on the Audit of the Financial Statements of the Province for the year ended 31 March 2008. My report on findings from reviews of Departments and Crown Agencies for the year ended 31 March 2008 was submitted and released on 21 January 2009.

TABLE OF CONTENTS

TABLE OF CONTENTS

CHAPTER 1

REFLECTIONS OF THE AUDITOR GENERAL

Reflections of the Auditor General

The following comments are made further to my audit of the Public Accounts of the Province for the year ended 31 March 2008. The Report provides additional information on the financial condition of Government measured by using indicators issued by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. The Report also offers comments on Government's compliance with generally accepted accounting principles and adherence to principles of sound financial accountability.

The Financial Condition of the Province (Chapter 3)

Each year in this part of my Reflections, I provide information on the financial condition of the Province, based on a review of the Public Accounts for such items as the change in net debt over the past year as well as the results of operations during the year. A similar analysis is provided again for the year ended 31 March 2008, which shows a $1.4 billion reduction in the Province's net debt (2007 - reduction of $126 million) and a $1.4 billion surplus for the year (2007 - $154 million surplus).

Government recently announced that for the first time since Confederation, Newfoundland and Labrador is considered to be a "Have Province". This means that for Federal equalization transfer purposes, we are considered to be financially self-reliant and will no longer receive these transfers. However, "Have Province" status is subject to future review and could change if the Province's fiscal situation changes.

However, the significant positive improvement in the Province's financial position during the year cannot be viewed in isolation. The optimism resulting from the improvement must be put into perspective by considering the important changes in the Province's economic situation since year end. Many of these changes have had or will have a significant impact on the Province's fiscal situation.

The most significant change is the current world economic downturn which resulted in a significant decline in the market value of the Province's pension fund assets since year end. In recent months there have been huge changes in oil prices which can have either a positive or negative impact depending on which way the price changes go. The Province will also be affected by impacts being felt directly by business in the Province resulting from the economic downturn, e.g. the impact on mining operations in Labrador and on pulp and paper operations in Grand Falls-Windsor.

While many of the changes being experienced have had or will have a significant negative impact on the Province's fiscal situation, there are others which are expected to have a significant positive impact. These include impacts from several recent events, e.g. development of the White Rose expansion oil fields, signing of an agreement with industry partners to develop the Hebron-Ben Nevis oil field, proposed construction of the Vale Inco hydromet facility in Long Harbour, developments with the Lower Churchill project, and reaching payout on the Hibernia project in the near future.

The following analysis is based on the financial position of the Province for the 2008 fiscal year. Readers are encouraged to reflect on the above comments in this section when considering the information provided.

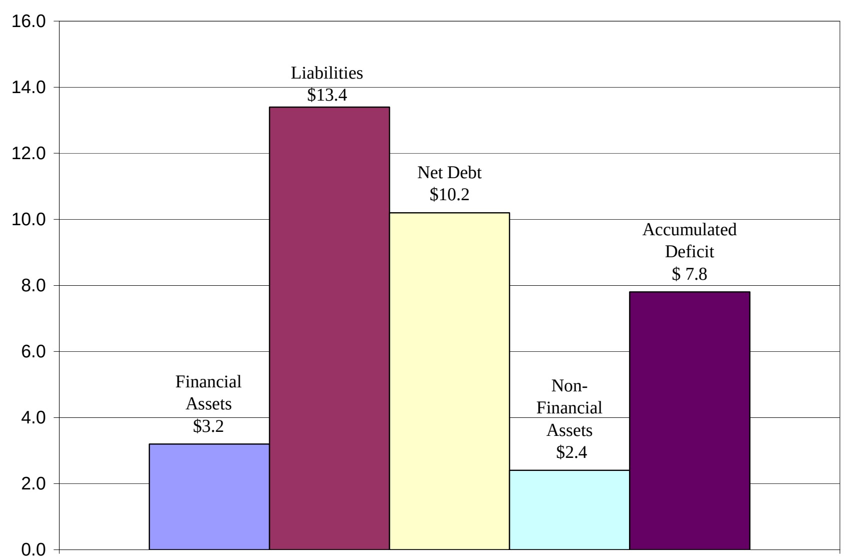
Net Debt

The Province's net debt as at 31 March 2008 was $10.2 billion, down $1.4 billion or approximately 12% from the $11.6 billion reported for 2007. While this is a significant decrease, the net debt, on a per capita basis, represents approximately $20,000 for each Newfoundlander and Labradorian. It remains the highest net debt per capita of any province in Canada, and based on information obtained from Government, is well above the national average of approximately $10,000 per capita. As well, at 35%, the Province still has one of the highest net debt as a percentage of GDP of any province and remains in one of the lowest credit rating categories of all provinces.

Figure 1 outlines the Province's financial position as at 31 March 2008 and shows the net debt of $10.2 billion, which is the difference between the Province's liabilities of $13.4 billion and its financial assets of $3.2 billion.

Figure 1

Province of Newfoundland and Labrador
Financial Position
As at 31 March 2008
($ Billions)



Net Debt =
Liabilities - Financial Assets;

Accumulated Deficit =
Net Debt - Non-Financial Assets

Results of Operations

In terms of operations for 2008, Government reported an annual surplus of $1.4 billion, up from a budget surplus of $261 million and also up from a reported surplus of $154 million for 2007. Total revenues increased from $5.5 billion in 2007 to $7.1 billion in 2008, while total expenses increased from $5.4 billion in 2007 to $5.7 billion in 2008.

Although recent surpluses may be perceived as being an abundance of money available for Government programs, Government will continue to be challenged to meet the expenditure needs of the Province, as well as the need to address its significant debt. In particular I note that for each dollar of revenue in 2008, approximately 57.0 cents was allocated as follows:

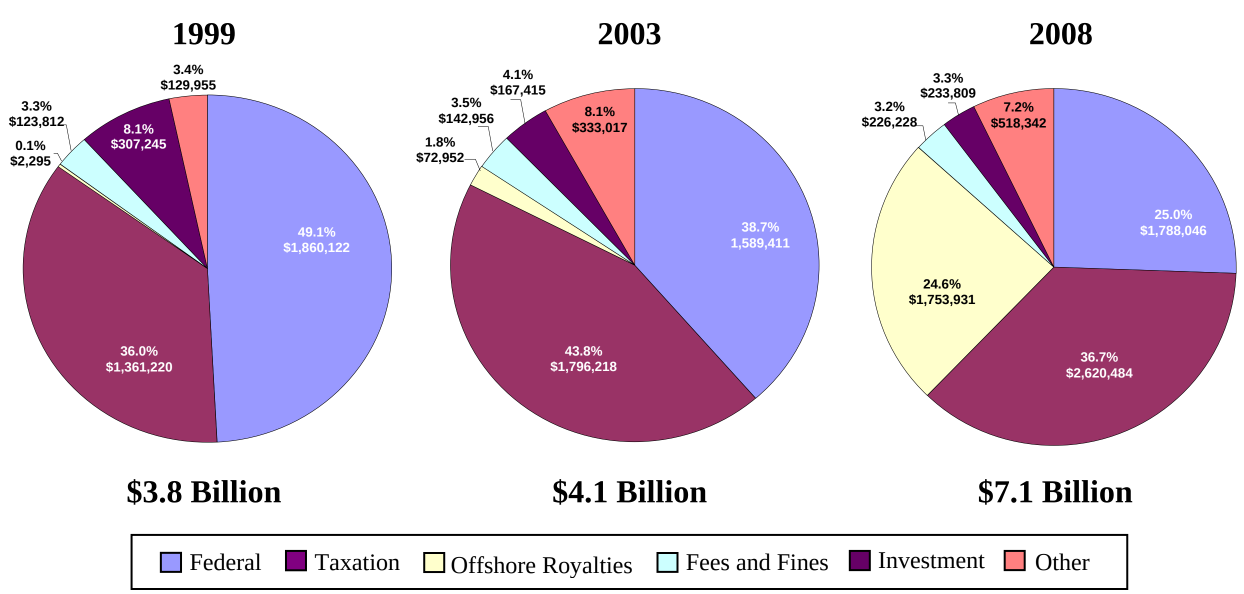
- 10.5 cents to pay the interest on our debt (also known as the "interest bite");
- 16.6 cents spent on education; and
- 29.9 cents spent for health and community services.

(a) Revenues

Figure 2 shows the total revenues of the Province by source for 1999, 2003 and 2008.

Figure 2

Province of Newfoundland and Labrador
Revenues by Source for 1999, 2003 and 2008
($ 000's)

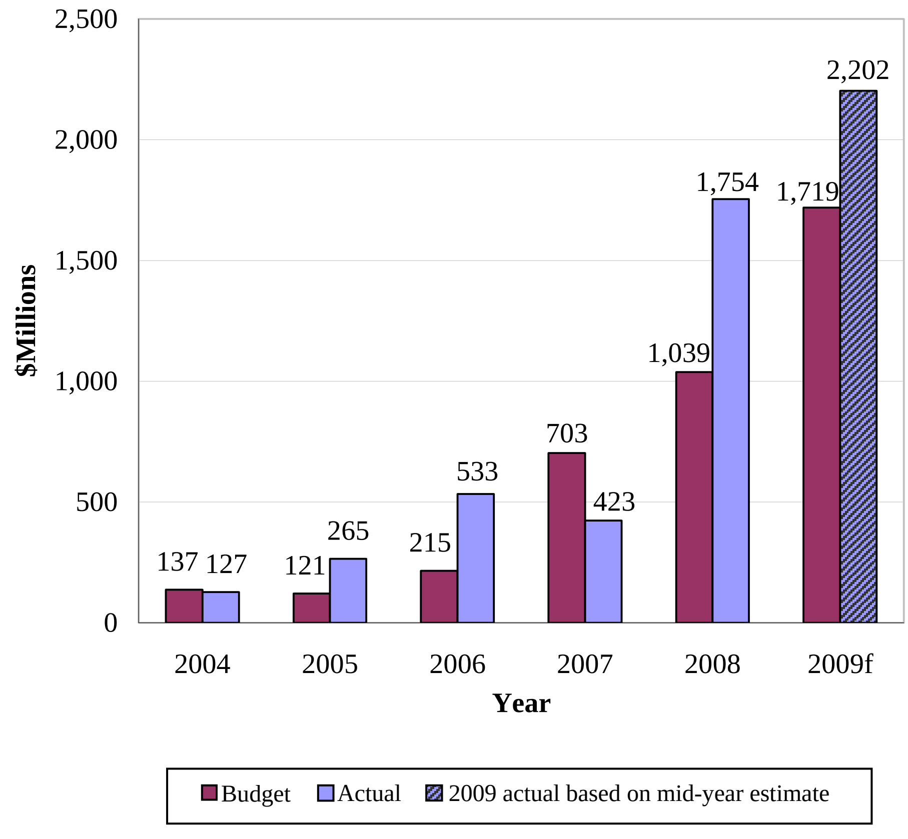


As Figure 2 shows, Federal revenues as a proportion of total revenues have decreased from 49.1% in 1999 to 25.0% in 2008, while the proportion of oil revenues has increased significantly from being an immaterial amount in 1999 to $1.8 billion (24.6%) in 2008.

Figure 3 shows budget and actual oil revenues from 2004 to 2008, with budget and revised forecasts for 2009.

Figure 3

Province of Newfoundland and Labrador
Oil Revenues: Budget and Actual
Years Ended 31 March
($ Millions)



As Figure 3 shows, actual oil revenues in 2008 of $1.8 billion exceeded budgeted oil revenues of $1.0 billion by $715 million or approximately 70%. This was in large part as a result of higher oil prices than originally forecast. I note that in 2007, while Government budgeted $703 million for oil revenues, actual oil revenues totalled only $423 million, a decrease of $280 million or 40%.

Furthermore, although oil revenue was budgeted for 2009 at $1.7 billion, in December 2008, Government announced an increase in its oil revenue estimates by $483 million to $2.2 billion in large part as a result of higher oil prices for a portion of that fiscal year.

There have been considerable fluctuations in the price of oil, from a high of approximately US$150 per barrel to US$40 by December 2008. Low oil prices will have a significant negative impact on the Province's future fiscal position. In fact, Government announced in December 2008 that if oil prices continue at below US$60 per barrel, there could be deficits of several hundred million dollars in the 2010 fiscal year, as well as potential deficits in subsequent years.

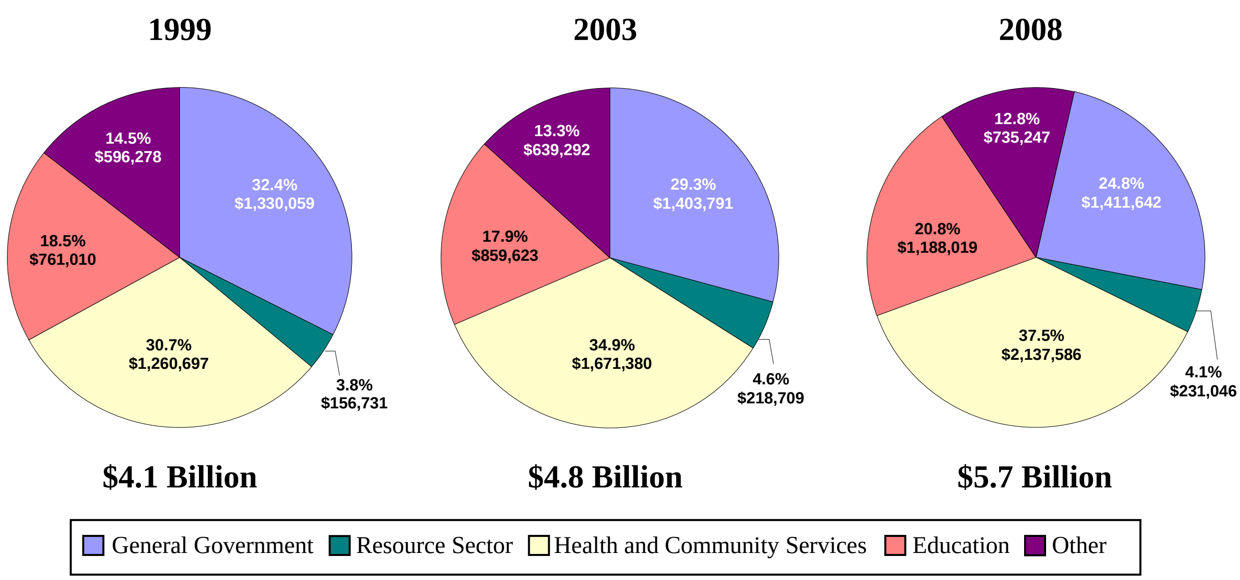
This information demonstrates the volatility that exists in predicting oil revenues. In most instances, the issues creating the volatility are outside of Government's control.

(b) Expenses

Figure 4 shows the total expenses of the Province by sector for 1999, 2003 and 2008.

Figure 4

Province of Newfoundland and Labrador
Expenses by Sector for 1999, 2003, and 2008
($ 000's)

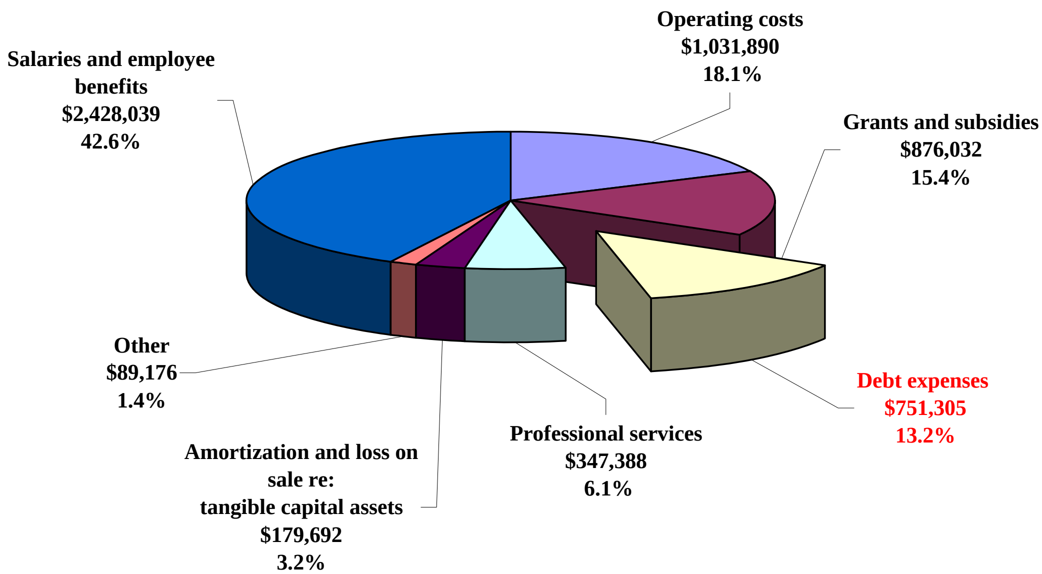


As Figure 4 shows, funding for the Departments of Health and Community Services, and Education have increased significantly since 1999. Funding for the Department of Health and Community Services has increased from $1.3 billion (30.7% of total expenses) in 1999 to $2.1 billion (37.5%) in 2008, while funding for the Department of Education has increased from $761 million (18.5% of total expenses) in 1999 to $1.2 billion (20.8%) in 2008. Combined funding for health and education totalled $3.3 billion and made up 58.3% of the total expenses in 2008.

Figure 5 shows expenses by type for the year ended 31 March 2008.

Figure 5

Province of Newfoundland and Labrador
Expenses by Type
Year Ended 31 March 2008
($ 000's)

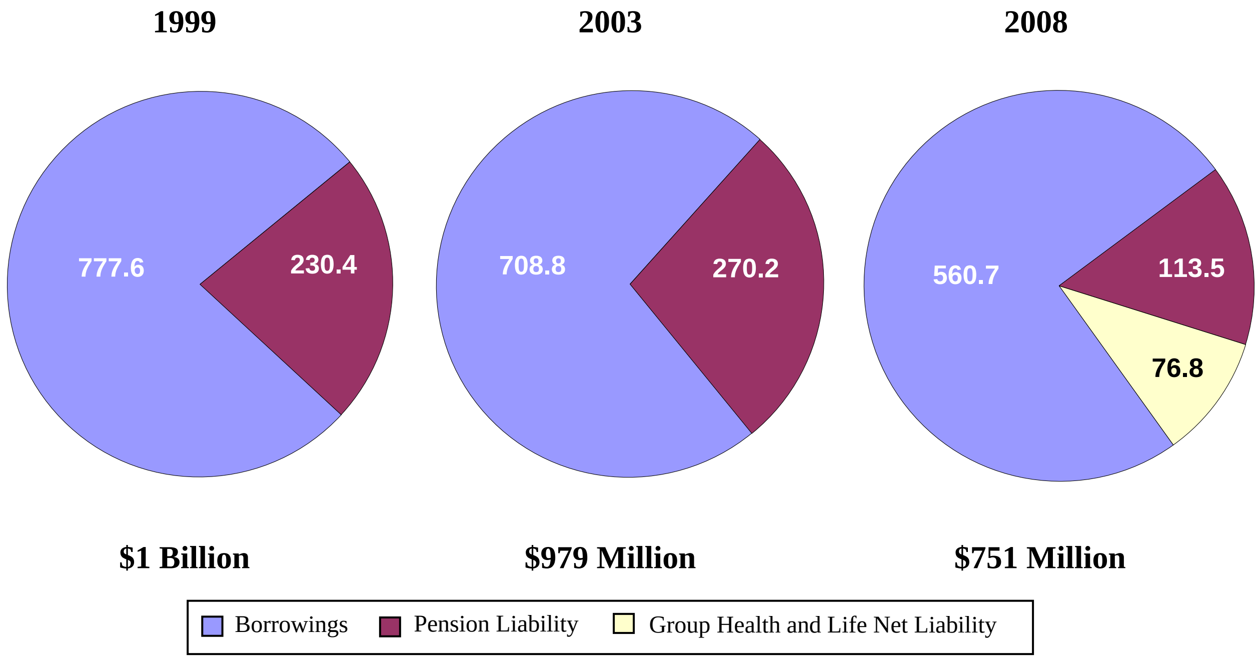


Total: $5.7 Billion

As Figure 5 shows, in 2008, the amount the Province had to pay to service the debt totalled $751 million. It remains one of the Province's major expenses. Figure 6 shows how much the Province had to pay to service the debt for 1999, 2003 and 2008.

Figure 6

Province of Newfoundland and Labrador
Debt Expenses for 1999, 2003 and 2008
($ Millions)



Note: Group Health and Life Net Liability was first reported in the 2004 Public Accounts

As Figure 6 shows, debt expenses decreased from approximately $1.0 billion in 1999 to $751 million in 2008. Although impacted by declining interest rates, the reduction was primarily caused when, in March 2006, the Province used approximately $2.0 billion of the proceeds from the Atlantic Accord (2005) agreement to reduce the unfunded liability of the Teachers' Pension Plan. While debt expenses have decreased, the Province still has one of the highest interest costs as a percentage of total revenues of any province in Canada, resulting in fewer resources to allocate to programs and services. Furthermore, the $1.6 billion decline in the market value of the Province's pension fund assets, subsequent to year end, will increase the unfunded pension liability and result in higher interest costs.

Summary

Although the Province has recorded a surplus for each of the past three years and has budgeted a surplus again for 2009, the following should be considered:

- The Province would need a surplus of $300 million each year for almost 34 years to eliminate its existing net debt of $10.2 billion, i.e. to be debt free.
- With Federal transfers at $1.8 billion (25.0%) of total revenues in 2008, the Province is still heavily reliant on the Federal government to help pay for the costs of such programs as health, education, and social services.
- Health and education expenses are increasing and accounted for $3.3 billion (58.3%) of total expenses in 2008 (in 2007 they accounted for $3.1 billion or 57.7% of total expenses).
- Recent annual surpluses have been due in large part to increased oil revenues, with actual oil revenues in 2008 of $1.8 billion exceeding budgeted oil revenues of $1.0 billion by $715 million or approximately 70%. While this is good for the Province, these revenues are generated from non-renewable resources and are very vulnerable to changes in world oil prices and production levels - factors which are outside Government’s control.
- The current world economic downturn has resulted in a significant decline in the market value of the Province’s pension fund assets since year end.

In addition to these factors, there are others which could significantly impact future annual surpluses or deficits, including an aging infrastructure, an aging population, changes in population migration, interest and currency rate fluctuations, changes in GDP, demand for Government programs and services, and changes in Federal programs and funding.

Given the significant fluctuations in operating results in the past and possibly in the coming years, it is important that Government take a cautious and informed approach to managing its financial resources.

As I reported last year, a review of other provinces in Canada indicated that most have some type of legislation which provides legislative direction on how budgets are developed and how surpluses are allocated. In addition, some provinces are required to specifically report to the Legislature on their reduction and management of public debt.

Retirement Benefits - Pensions (Part 4.1)

The Province's unfunded pension liability as at 31 March 2008 totalled $1.5 billion, a decrease of $466 million or approximately 25% from the balance of $1.9 billion as at 31 March 2007. The main reason for the decrease in the unfunded pension liability was the payment of $582 million by the Province during 2007-08 to help reduce the Public Service Pension Plan's unfunded liability. The $1.5 billion unfunded pension liability continues to represent a significant debt for Government, which, in 2008, cost the Province $113.5 million in interest.

I note that, although there was a reduction in the Province's overall unfunded pension liability in 2008, the liability increased by a total of $55.2 million in four of the six pension plans: the Teachers' Pension Plan ($32.8 million); the Uniformed Services Pension Plan ($17.8 million); the Members of the House of Assembly Pension Plan ($4.0 million); and the Provincial Court Judges' Pension Plan ($0.6 million).

As indicated in the Consolidated Summary Financial Statements, subsequent to 31 March 2008, there was a significant decline in the market value of the Province's pension fund assets. The market value decreased from approximately $7.2 billion as at 31 March 2008 to $5.6 billion in November 2008, a decrease of $1.6 billion. It was disclosed in the statements that the reason for this significant decline was the effect that the global economic uncertainty has had on the financial markets. This decline in asset value means that the Province's unfunded liability has increased.

The unfunded pension liability continues to be a significant debt. Addressing this liability should remain a priority for Government.

Retirement Benefits - Group Health and Life Insurance (Part 4.2)

The liability for group health and group life insurance retirement benefits has added to the already considerable debt load of the Province and is expected to increase in each of the next four years. The net liability as at 31 March 2008 was $1.5 billion (2007 - $1.4 billion). By 2012, the net liability is expected to total $1.9 billion, an increase of approximately $400 million or 27% over 2008, if action is not taken to address it.

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

Environmental Liabilities (Part 5.3)

Although the Province's environmental liability relating to remediation costs for contaminated sites may be a significant amount, only $8.3 million was recorded as a liability in the Province's financial statements as at 31 March 2008 (2007 - $7.3 million). As I have outlined in previous years, a report made public by Government in 2004 referred to an estimated cost of more than $237 million relating to the remediation of contaminated sites in the Province. The most significant environmental issue reflected in the report related to regional waste sites.

Government has made little progress in this area since I first reported my concerns in 2002. It should be more proactive in identifying all contaminated sites in the Province for which it is potentially liable, determining the estimated liability associated with remediation costs, and recording the resulting liability in the Province's financial statements.

Acknowledgements

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

JOHN L. NOSEWORTHY, CA
Auditor General

CHAPTER
2
INTRODUCTION

Introduction

Background

This report presents information on the Province's financial statements (commonly referred to as the Public Accounts). These financial statements provide an important link in an essential chain of public accountability. They 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.

The Consolidated Summary Financial Statements are prepared on the accrual basis of accounting in accordance with the accounting standards established for governments by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA), and as outlined in the significant accounting policies of the Province.

The statements provide the most complete information about the operating results and financial position of the Province. They combine the results of operation of the Consolidated Revenue Fund, which accounts for the financial activities of the central Government and the departments, with those of other Government entities.

For the year ended 31 March 2008, the Public Accounts contain the Consolidated Summary Financial Statements, the Auditor General's Report on those financial statements, and other information which Government is required to include or chooses to include.

In this report, I comment on the Consolidated Summary Financial Statements and present a summary of certain financial information contained in those financial statements. I have also included two appendices. Appendix I presents answers to questions I am frequently asked in relation to the Public Accounts, while Appendix II presents a glossary of terms used in the Public Accounts.

2.1 Legislative Requirements

In accordance with section 59 of the *Financial Administration Act*, Government prepares a document called the Public Accounts which includes the Consolidated Summary Financial Statements of the Province and the Consolidated Revenue Fund Financial Statements. In accordance with the *Act* 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 for under the *Financial Administration Act*.

Section 11 of the *Auditor General Act* requires that the Auditor General express an opinion as to whether the financial statements 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.

2.2 Responsibility for the Public Accounts

Government is responsible for providing the House of Assembly with the Province's financial statements (the Public Accounts). While Treasury Board prescribes the manner and form in which the Public Accounts of the Province are prepared, the actual statements, schedules and notes are prepared by the Comptroller General.

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. The Statement indicates that *"Responsibility for the integrity, objectivity and fair presentation of the consolidated summary financial statements of the Province of Newfoundland and Labrador rests with the Government. As required under Section 59 of the* Financial Administration Act*, these consolidated summary financial statements are prepared by the Comptroller General of Finance in accordance with the applicable legislation and in accordance with the accounting policies as disclosed in Note 1 to these consolidated summary financial statements. These consolidated summary financial statements are prepared based upon information provided by the various Government departments and the noted Crown corporations, boards and authorities pursuant to Section 19 of the* Transparency and Accountability Act *and Section 20 of the* Financial Administration Act*. The Government is responsible for maintaining a system of internal accounting and administrative controls in order to provide reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records are properly maintained."*

2.3 Auditor's Report on the Financial Statements of the Province

The Auditor's Report on the Consolidated Summary Financial Statements of the Province for the year ended 31 March 2008 reads as follows:

To the House of Assembly
Province of Newfoundland and Labrador

I have audited the consolidated statement of financial position of the Province of Newfoundland and Labrador as at 31 March 2008 and the consolidated statements of change in net debt, operations, change in accumulated deficit and cash flows for the year then ended. These financial statements are the *responsibility of Government. My responsibility is to express an opinion on these financial statements based on my audit.*

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Government, as well as evaluating the overall financial statement presentation.

In my opinion, these consolidated summary financial statements present fairly, in all material respects, the financial position of the Province of Newfoundland and Labrador as at 31 March 2008 and the results of its operations, the changes in its net debt and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles and, pursuant to section 11 of the Auditor General Act, *in accordance with the accounting policies of the Provincial government as disclosed in Note 1 to these financial statements applied on a basis consistent with that of the preceding year.*

JOHN L. NOSEWORTHY, CA
Auditor General

St. John's, Newfoundland and Labrador
18 November 2008

2.4 How do our Financial Statements Compare to Other Jurisdictions?

The Consolidated Summary Financial Statements are the principal financial statements of the Province and are in full compliance with the requirements of Canadian generally accepted accounting principles for government. In my opinion, the Province's financial statements are as good as the financial statements of any jurisdiction in Canada.

CHAPTER 3

FINANCIAL CONDITION OF THE PROVINCE

Financial Condition of the Province

Introduction

Each year in this Chapter, I present key financial information contained in the Public Accounts. I also present information on the financial condition of the Province, including a discussion of financial indicators in the Newfoundland and Labrador context. These financial indicators are intended to assist the reader in interpreting the financial information contained in the Public Accounts and to more completely understand the significance of the information provided.

The information on the Province's financial position during the year, provided in the following sections, must be put into perspective by considering the important changes in the Province's economic situation since year end. Many of these changes have had or will have significant impact on the Province's fiscal situation.

Perhaps the most significant change is the current world economic downturn. This has already resulted in a significant $1.6 billion decline in the market value of the Province's pension fund assets since year end. These assets declined from $7.2 billion as at 31 March 2008 to approximately $5.6 billion in November 2008. The considerable decrease in the price of oil, from a high of approximately US$150 per barrel to US$40 by December 2008, will also have a significant negative impact on the Province's future fiscal position. While oil prices in the first eight months of the 2009 fiscal year were higher than Government forecasted and will likely result in a higher than budgeted surplus for that year, Government announced in December that if oil prices continue at below US$60 per barrel, there could be deficits of several hundred million dollars in the 2010 fiscal year, as well as potential deficits in subsequent years. The Province will also be affected by impacts being felt directly by business in the Province resulting from the economic downturn, e.g. the impact on mining operations in Labrador and on pulp and paper operations in Grand Falls-Windsor.

While many of the changes being experienced have had or will have a significant negative impact on the Province's fiscal situation, there are others which are expected to have a significant positive impact. These include impacts from several recent events, e.g. development of the White Rose expansion oil fields, signing of an agreement with industry partners to develop the Hebron-Ben Nevis oil field, proposed construction of the Vale Inco hydromet facility in Long Harbour, developments with the Lower Churchill project, and reaching payout on the Hibernia project in the near future.

It is also important to note that Government recently announced that for the first time since Confederation, Newfoundland and Labrador is considered to be a "Have Province". This means that for Federal equalization transfer purposes, we are considered to be financially self-reliant and will no longer receive these transfers. However, "Have Province" status is subject to future review and could change if the Province's fiscal situation changes.

The following analysis is based on the financial position of the Province for the 2008 fiscal year. Readers are encouraged to reflect on the above comments when considering the information provided.

3.1 Key Balances in the Public Accounts

There are five key balances in Volume I of the Public Accounts, i.e. the Consolidated Summary Financial Statements - net debt, accumulated deficit, surplus (deficit), revenue and expense.

Net Debt

Net debt as at 31 March 2008 was $10.2 billion (2007 - $11.6 billion). This is the amount by which the Province's liabilities of $13.4 billion (2007 - $13.7 billion) exceeded its financial assets of $3.2 billion (2007 - $2.1 billion). It is also considered to be the amount which the Government of the day leaves for future Governments to either repay or refinance.

Accumulated Deficit

The accumulated deficit as at 31 March 2008 was $7.8 billion (2007 - $9.2 billion). This is the total net amount of all annual surpluses and deficits experienced by the Province.

Surplus (Deficit)

The consolidated surplus for the year ended 31 March 2008 was $1.4 billion (2007 - $154 million). The $1.4 billion surplus for 2008 is the amount by which the Province's total revenue of $7.1 billion exceeded its total expense of $5.7 billion. The $154 million surplus for 2007 is the amount by which the Province's total revenue of $5.5 billion exceeded its total expense of $5.4 billion.

Revenue

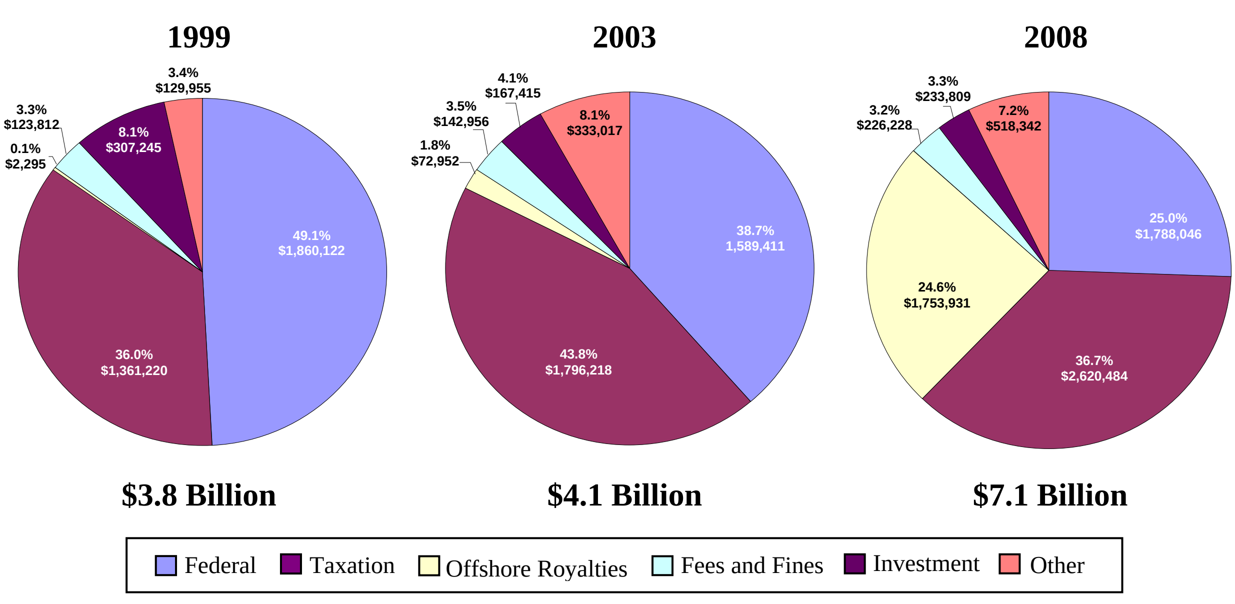
Total revenue for the year ended 31 March 2008 was $7.1 billion (2007 - $5.5 billion). Revenues consist of:

- revenues received from the Government of Canada including equalization transfers;
- own source revenues generated by the Province e.g. through taxation, offshore royalties, fees and fines;
- revenues from investments; and
- other revenue sources, including net income of Government business enterprises - considered as organizations which carry on business and sell goods and services to individuals and non-Government organizations as their principal activity and source of revenue. The Government business enterprises included in the 2008 Consolidated Summary Financial Statements consisted of the Newfoundland and Labrador Liquor Corporation (year ended 5 April 2008) and Newfoundland and Labrador Hydro (year ended 31 December 2007).

Figure 1 shows the total revenues of the Province by source for 1999, 2003 and 2008.

Figure 1

Province of Newfoundland and Labrador
Revenues by Source for 1999, 2003 and 2008
($ 000's)



As Figure 1 shows, Federal revenues as a proportion of total revenues have decreased from 49.1% in 1999 to 25.0% in 2008, while the proportion of oil revenues has increased significantly from being an immaterial amount in 1999 to 24.6% in 2008.

Expense

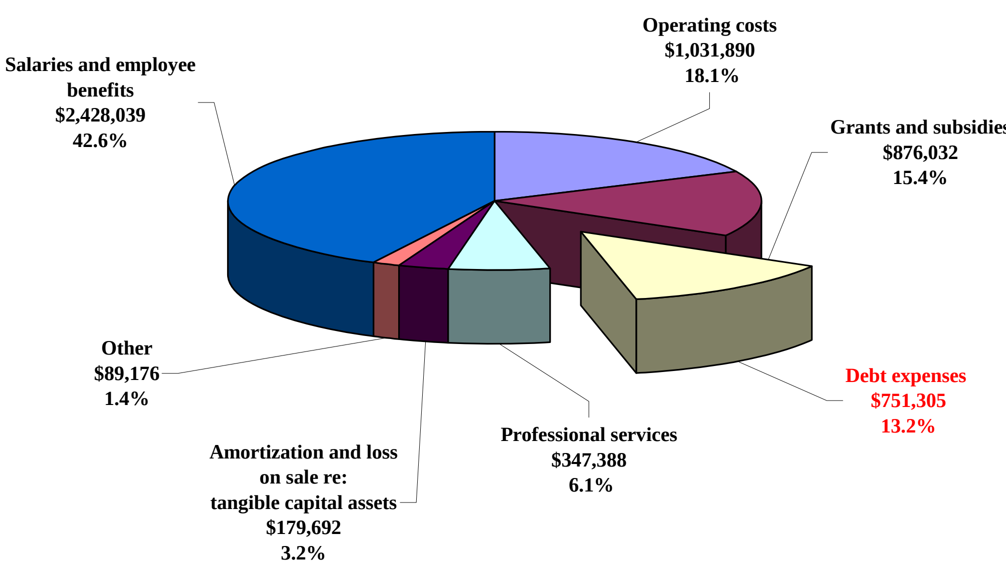
Total expense for the year ended 31 March 2008 was $5.7 billion (2007 - $5.4 billion). Expenses include:

- salaries and employee benefits;
- debt expenses;
- operating costs;
- grants and subsidies; and
- other costs to Government of providing programs and services.

Figure 2 shows the total expenses of the Province by type for 2008.

Figure 2

Province of Newfoundland and Labrador
Expenses by Type for 2008
($000's)

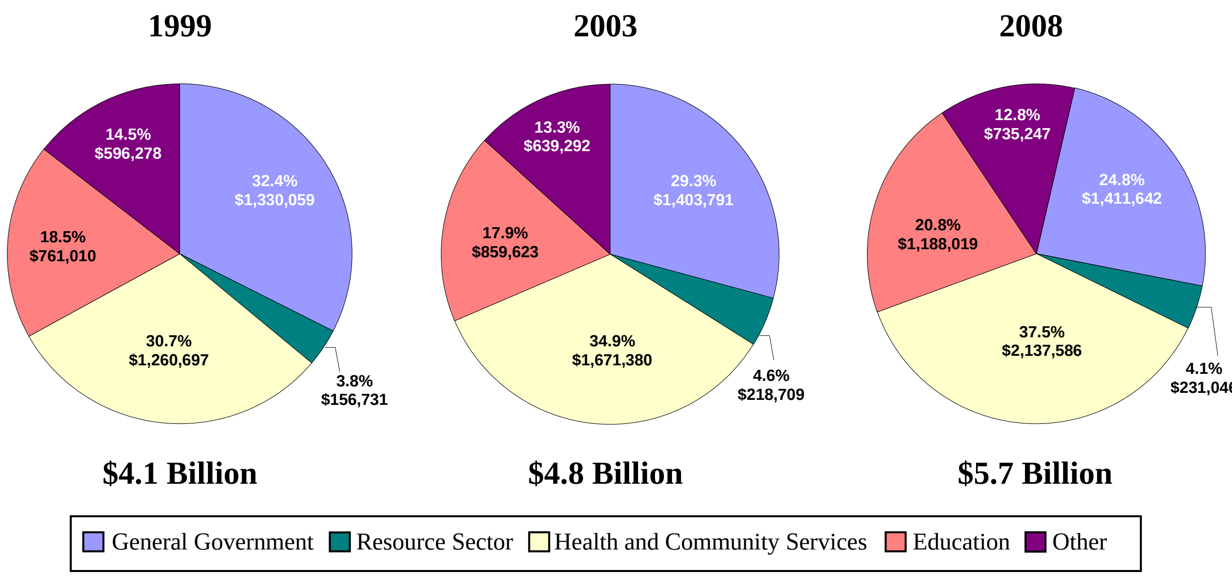


Total: $5.7 Billion

Expenses are summarized in the statements by the three sectors - general Government sector, resource sector, and social sector (including health and community services, education, and other social sector areas). Figure 3 shows the expenses of the Province by sector for 1999, 2003 and 2008.

Figure 3

Province of Newfoundland and Labrador
Expenses by Sector for 1999, 2003, and 2008
($ 000's)



As Figure 3 shows, funding for the Departments of Health and Community Services, and Education have increased significantly since 1999. Funding for the Department of Health and Community Services has increased from $1,260,697 (30.7% of total expenses) in 1999 to $2,137,568 (37.5% of total expenses) in 2008, while funding for the Department of Education increased from $761,010 (18.5% of total expenses) in 1999 to $1,188,019 (20.8% of total expenses) in 2008. Combined funding for health and education made up 58.3% of the total expenses in 2008, up from 49.2% in 1999.

Key Balances

A summary of key balances contained in the Consolidated Summary Financial Statements is provided in Figure 4.

Figure 4

Consolidated Summary Financial Statements
Key Balances
Years Ended 31 March
($ Billions)

Balance	2004	2005	2006	2007	2008
Statement of Financial Position					
Financial Assets	1.399	1.845	2.118	2.104	3.177
Liabilities	12.886	13.733	13.802	13.662	13.365
Net Debt	**11.487**	**11.888**	**11.684**	**11.558**	**10.188**
Non-Financial Assets	2.176	2.135	2.289	2.316	2.436
Accumulated Deficit	**9.311**	**9.753**	**9.395**	**9.242**	**7.752**
Statement of Operations					
Revenue	4.219	4.483	5.556	5.521	7.141
Expense	5.133	4.972	5.357	5.367	5.704
Annual Surplus (Deficit)	**(0.914)**	**(0.489)**	**0.199**	**0.154**	**1.437**

Source: Consolidated Summary Financial Statements

While Government's financial condition has improved, its net debt of $10.2 billion is still quite high, with net debt per capita of approximately $20,000 as at 31 March 2008, still the highest in the country. Based on information obtained from Government, this is well above the national average of approximately $10,000 per capita.

Also, while the Province's economic growth has been positive, its ability to raise its own source revenue remains vulnerable to recent changes in the economy, including changes due to fluctuations in oil prices and production levels, the Canadian dollar and interest rates.

With regards to oil revenues, the Province is becoming increasingly reliant on these revenues due to growth in this revenue source in recent years. Actual oil revenue in 2004 was $127 million and increased by $1.627 billion to

$1.754 billion in 2008. These revenues are generated from non-renewable resources and are very vulnerable to changes in world oil prices and production levels - both outside the control of Government. As a result, there can be significant variances between Government estimated revenue and actual revenue which can have significant impacts on fiscal performance.

To illustrate, in December 2008, Government increased its oil revenue estimate for the 2008 fiscal year by $483 million. This had a significant impact on the expected fiscal outlook and was a major factor in changing the original estimated surplus of $544 million to a projected surplus of $1.266 billion for the 2009 fiscal year. Conversely, the recent significant decrease in oil prices will likely result in future reductions in oil revenues and a related negative impact on the Province's financial condition.

Government has committed to addressing past annual deficits, and for 2008 reported a surplus of $1.437 billion. Oil prices in the first eight months of the 2009 fiscal year were higher than Government forecasted and will likely result in a higher than budgeted surplus for that year; however, Government announced in December that if oil prices continue at below US$60 per barrel, there could be deficits of several hundred million dollars in the 2010 fiscal year, as well as potential deficits in subsequent years. It is important that Government continue with efforts to spend within its means and consider a reasonable plan to reduce the Province's substantial net debt of $10.2 billion.

There has to be a continued improvement in Government's financial results in order to support a reasonable plan to address the substantial net debt. By way of illustration, consider that the Province would require a surplus of $300 million each year for almost 34 years to eliminate its current net debt of $10.2 billion.

Maintaining a substantial net debt means incurring significant annual costs to service that debt. It also means that these annual costs could change significantly due to changes in interest rates. Debt expenses for the year ended 31 March 2008 totalled $751 million, which represents 10.5% of total revenues (also known as the "interest bite"). This means that the Province spent $751 million to pay financing costs associated with debt incurred in the past, as well as changes in the unfunded pension liability and the liability for group health and life insurance retirement benefits. As a result, that amount was not available to spend on programs and services. Furthermore, at 31 March 2008, the Province had $847 million in U.S. debt (net of sinking fund assets). Therefore it has exposure to currency fluctuations. For example, a 1 cent change in exchange rates would have an impact of $10.5 million on the Province's debt.

Although Government recently announced that Newfoundland and Labrador is considered a "Have Province", the Province remains heavily reliant on transfers from the Federal Government in order to fund its programs and services. Of the Province's total revenue of $7.1 billion for the year ended 31 March 2008, $1.8 billion or 25% resulted from Federal transfers.

Aside from the risk of fluctuating revenues, Government faces continued demand for expenditures, especially in health and education. Expenses in these two departments over the last seven years increased by $1.3 billion (or 65%) from $2.0 billion for 2001 to $3.3 billion for 2008, and accounted for 58% of total Government expenses for the year ended 31 March 2008.

There are other factors which could also result in changes to the annual surplus or deficit, including an aging infrastructure, an aging population, and changes in population migration. With respect to changes in population migration, it is noted there was an increase in population for the Province of 1,436 from 1 July 2007 to 1 July 2008. This is the first increase in the population for Newfoundland and Labrador since 1992.

Figure 5 provides details of the Province's liabilities, annual surplus (deficit), net debt and debt expenses for the years 1995 to 2008 as reported in the Consolidated Summary Financial Statements of the Province.

Figure 5

Consolidated Summary Financial Statements
Liabilities, Annual Surplus (Deficit), Net Debt and Debt Expenses
Years Ended 31 March
($ Millions)

Year	Net Borrowing and other Liabilities	Unfunded Pension Liability	Group Health and Life Insurance Benefits Liability	Total Liabilities	Annual Surplus (Deficit)	Net Debt	Debt Expenses
1995	6,535	2,686		9,221	(374)	6,831	1,004
1996	6,725	2,739		9,464	(190)	7,121	822
1997	6,730	2,943		9,673	(107)	7,254	819
1998	6,373	3,134		9,507	133	7,301	865
1999	6,758	3,352		10,110	(187)	7,851	1,008
2000	6,689	3,309		9,998	(269)	8,087	883

Year	Net Borrowing and other Liabilities	Unfunded Pension Liability	Group Health and Life Insurance Benefits Liability	Total Liabilities	Annual Surplus (Deficit)	Net Debt	Debt Expenses
2001	6,801	3,348		10,149	(350)	8,437	951
2002	7,270	3,392		10,662	(468)	8,932	942
2003	7,581	3,557	985	12,123	(644)	10,616	979
2004	8,073	3,746	1,067	12,886	(914)	11,487	982
2005	8,640	3,934	1,159	13,733	(489)	11,888	940
2006	10,336(1)	2,201	1,265	13,802	199	11,684	947
2007	10,334(2)	1,925	1,403	13,662	154	11,558	777
2008	10,393(3)	1,459	1,513	13,365	1,437	10,188	751
Total					**(2,089)**		**12,670**

(1) Includes deferral of $1.678 billion Atlantic Accord (2005) money.
(2) Includes deferral of $1.459 billion Atlantic Accord (2005) money.
(3) Includes deferral of $1.153 billion Atlantic Accord (2005) money.

As Figure 5 shows, prior to 2006, the Province had substantial deficits and interest costs and an increasing net debt each year. There was some improvement in 2006 and 2007 and a significant improvement in 2008. The total deficit reported over the 14 year period is $2.1 billion, with total debt expenses over the same period of $12.7 billion.

Although the Province had budgeted a surplus of $261 million for 2008, it had an actual surplus of $1.4 billion. Figure 6 provides details on the budget forecast compared to actual results for the year ended 31 March 2008.

Figure 6

Consolidated Summary Financial Statements
Actual Compared to Budget
As at 31 March 2008
($000's)

	Actual	Original Estimates	Impact on Surplus	% of Impact
REVENUE				
Provincial				
Taxation	2,620,484	2,391,499	228,985	19.5%
Investment	233,809	205,734	28,075	2.4%
Fees and fines	226,288	218,324	7,964	0.7%
Offshore royalties	1,753,931	1,038,600	715,331	60.8%
Other	319,583	344,952	(25,369)	(2.2%)
Government of Canada	1,788,046	1,794,931	(6,885)	(0.6%)
Net income of Government business enterprises	198,759	195,450	3,309	0.3%
Total Revenue	**7,140,900**	**6,189,490**	**951,410**	**80.9%**
EXPENSE				
General Government Sector	1,411,642	1,386,816	(24,826)	(2.1%)
Resource Sector	231,046	294,347	63,301	5.4%
Social Sector	4,060,834	4,247,147	186,313	15.8%
Total Expense	**5,703,522**	**5,928,310**	**224,788**	**19.1%**
SURPLUS	**1,437,378**	**261,180**	**1,176,198**	**100.0%**

As Figure 6 shows, the significant increases in offshore royalties' revenue ($715 million) and taxation revenue ($229 million), along with a net reduction of expenses of $225 million, were major factors in why the projected surplus of $261 million became an actual surplus of $1.437 billion.

For 2008, the amount of Government of Canada revenue which the Province received increased by $45 million compared to 2007. There was also an increase in Provincial Government revenues (including net income from Government business enterprises) of $1.574 billion. This increase primarily related to an increase of $1.331 billion in oil royalties. During the year, salaries and other operating expenses increased by approximately $256 million. This was offset by the savings in interest expenses of $26 million largely due to the continued effect of the payment of approximately $2.0 billion on the unfunded pension liability of the Teachers' Pension Plan in 2005.

As a result of the $1.620 billion increase in revenue and the $337 million increase in expenses, the Province's annual surplus was increased by $1.283 billion from $154 million in 2007 to $1.437 billion in 2008.

Now that the Province is receiving higher revenues and is in a surplus position rather than its traditional deficit position, Government must make difficult decisions on how best to use the surplus. Government is faced with many alternatives and demands in this regard, including: reducing taxes and fees; using the additional funding for social and other programs; replacing or upgrading its infrastructure; and reducing its significant debt burden.

As I reported last year, we reviewed the legislation of other provincial jurisdictions to determine what if any legislation they had relating to balanced budget and/or debt reduction, how budgets are developed and how surpluses are allocated. Our review disclosed that:

- Eight provinces (British Columbia, Saskatchewan, Alberta, Manitoba, Ontario, Quebec, New Brunswick, and Nova Scotia) have some form of balanced budget legislation. It was noted that Nova Scotia used its Offshore Offset Funding to pay down its debt and that this funding revenue is not considered revenue for purposes of its annual balanced budget calculation.

- Four provinces (British Columbia, Ontario, Quebec and New Brunswick) have legislative direction or policy to reduce their debt to GDP ratio. Quebec is specifically directed to reduce its percentages to 38% by 2013, 32% by 2020 and 25% by 2026.

- Three provinces (Manitoba, Quebec and Nova Scotia) have debt retirement funds.

In addition, four provinces (British Columbia, Alberta, Saskatchewan and New Brunswick) are required to specifically report to the Legislature on their reduction and management of public debt.

3.2 Financial Indicators

An important role for my Office is to provide Members of the House of Assembly with information on the state of Government's finances. This information is necessary in order to have an informed debate about the issues that Government has to address. Issues include the ability of Government to fund programs and services, where the revenues will come from and the impact of surpluses, deficits, and debt.

The Public Sector Accounting Board recently issued a draft Statement of Recommended Practice on indicators of financial condition that governments should use that will help the average person understand whether a government is better or worse off than the year or years before.

These indicators combined indicate the financial condition of a government: its financial health as measured by **sustainability**, **flexibility** and **vulnerability**, looked at in the context of the overall economic and financial environment. An explanation of these terms are as follows:

- **Sustainability** - whether a government is living within its means;
- **Flexibility** - whether a government can meet rising commitments by expanding its revenues or increasing its debt; and
- **Vulnerability** - the extent to which a government relies on money from the Federal government or other outside sources to pay for existing provincial programs.

In this section, the indicators are discussed in the Newfoundland and Labrador context. Each indicator can and should be analyzed in detail, combined with other information, and monitored over time.

3.2.1 Sustainability

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

- annual surplus or deficit;
- net debt and a province's gross domestic product (GDP) in relation to net debt;
- net debt as a percentage of province's GDP;
- Canadian and U.S denominated borrowings;
- borrowings and sinking funds; and
- debt expenses.

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

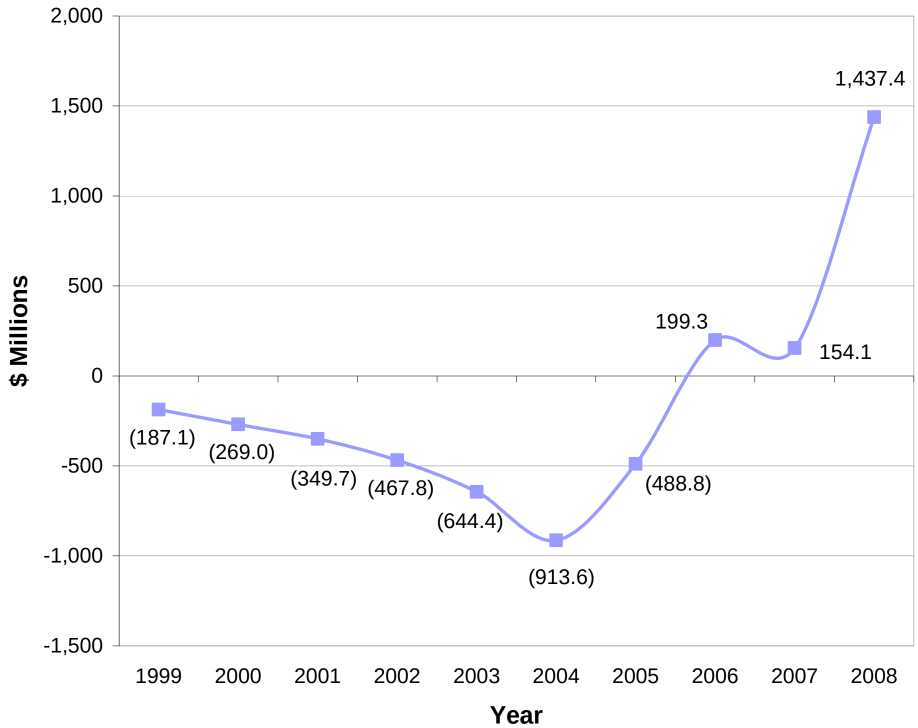
(a) Annual surplus or deficit

The annual surplus or deficit shows the extent to which a government spends less or more than it raises in revenues in one fiscal year. It is an indicator of whether a government is living within its means.

For the year ended 31 March 2008, the annual surplus reflected in the Province's Consolidated Summary Financial Statements was $1.437 billion. Figure 7 provides details as to the annual surplus or deficit each year from 1999 to 2008.

Figure 7

Consolidated Summary Financial Statements
Annual Surplus (Deficit)
Years Ended 31 March
($ Millions)



As Figure 7 shows, with the exception of 2006, 2007 and 2008, Government had an annual deficit each year. In 2006, there was a reported surplus of $199 million, the first surplus since 1998. The Figure also shows that Government's annual deficit grew each year from 1999 to 2004, with the deficit of $914 million in 2004, representing the largest annual deficit recorded by the Province. Government also had a deficit in 2005; however, it had decreased from the record deficit in 2004, to $489 million. For 2006, Government had a surplus of $199 million, which was due in large part to an increase in oil revenue and an increase in Government of Canada revenue. There was also a surplus in 2007; however, it had decreased from 2006 to $154 million.

(b) Net debt and a province's gross domestic product (GDP) in relation to net debt

Users of a province's financial statements should look at long-term trends such as net debt to GDP and net debt as a percentage of GDP. Such trends are further indicators of whether a government is living within its means.

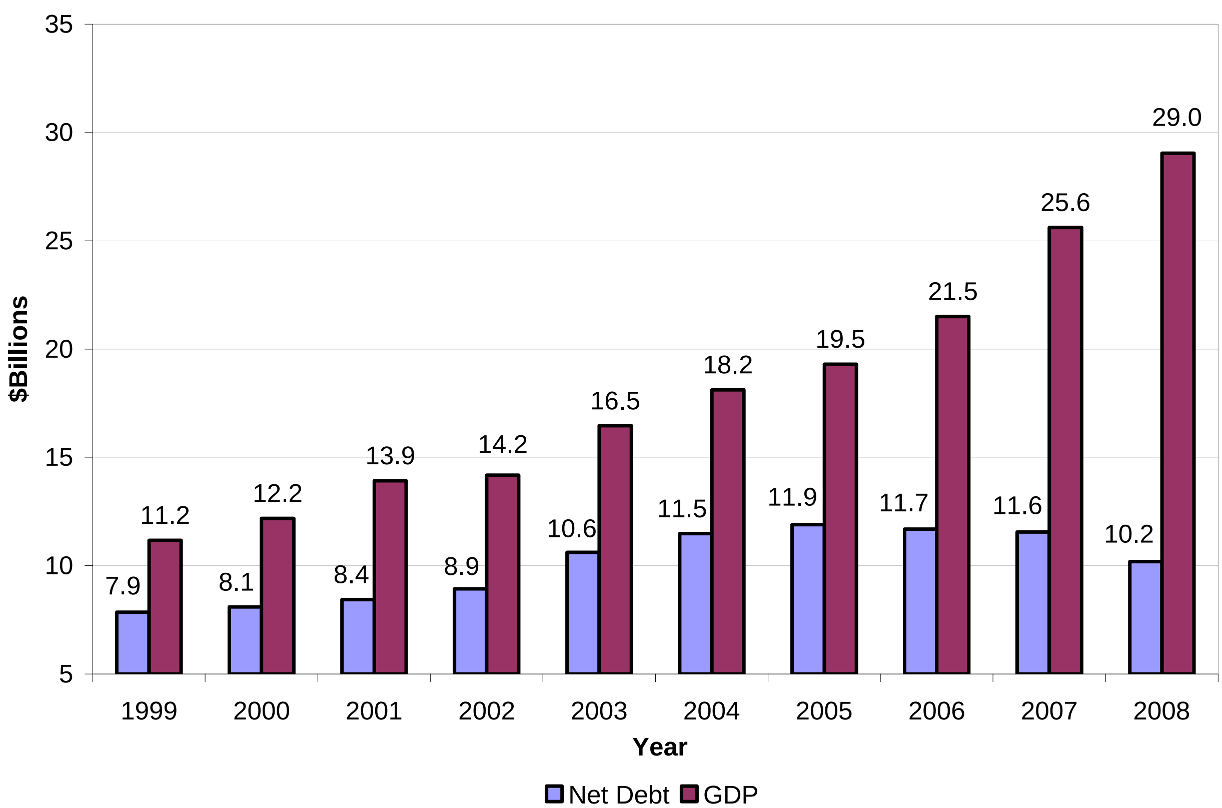
Net debt is the total of all liabilities reduced by financial assets (e.g. cash, temporary investments, and receivables). It is the amount which the government of the day leaves for future governments to either repay or refinance. As at 31 March 2008, the net debt reflected in the Province's Consolidated Summary Financial Statements was $10.2 billion.

The Province's GDP is a measure of the total value of all goods and services produced in Newfoundland and Labrador in one year. It is the number most often used to indicate the size of a provincial economy. Government must manage its revenue raising and spending practices in the context of the economy of the Province.

Figure 8 provides details as to the net debt in relation to GDP from 1999 to 2008. For purposes of this report, GDP for 2008 is reported at $29 billion, based on information obtained from the Provincial Department of Finance.

Figure 8

Consolidated Summary Financial Statements
Net Debt in Relation to GDP
Years Ended 31 March
($ Billions)



As Figure 8 shows, the GDP of Newfoundland and Labrador increased substantially from 1999 to 2008. The 2008 GDP of $29 billion is an increase of $17.8 billion (159%) from the 1999 GDP of $11.2 billion. Figure 8 also shows that the Province's net debt increased each year from 1999 to 2005, decreased slightly in 2006 and 2007, and decreased more significantly in 2008.

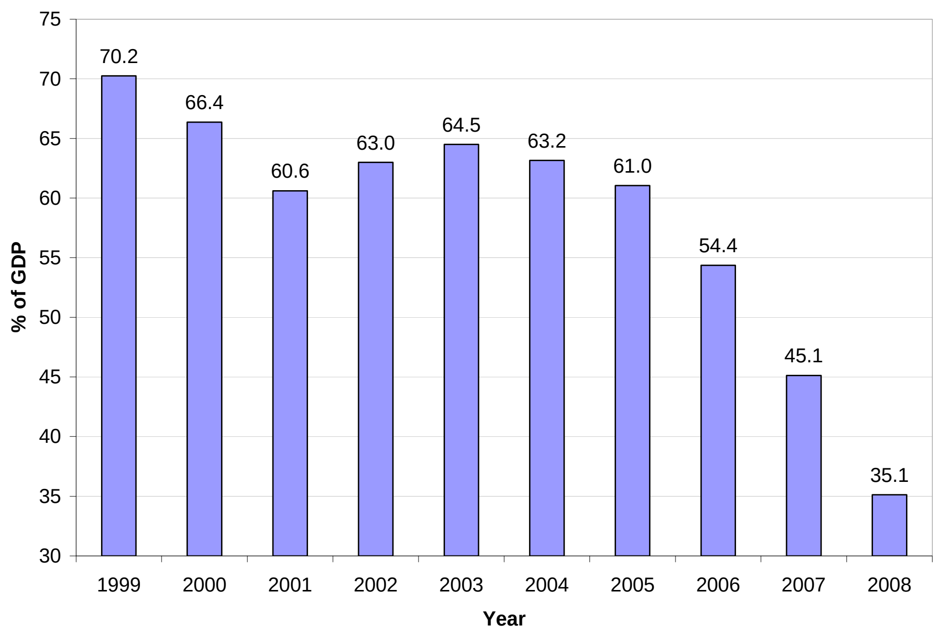
(c) Net debt as a percentage of province's gross domestic product (GDP)

The financial demands placed on the economy by Government's spending and revenue raising practices can be assessed for sustainability by comparing Government's net debt to the Province's GDP. The thinking behind this measure is that the larger the GDP the more debt Government can afford to carry.

While the Province's net debt has decreased in recent years, the Provincial GDP has been increasing. Therefore, as shown in Figure 9, the net debt as a percentage of GDP has decreased significantly. The net debt of the Province as a percentage of GDP in 2008 was 35.1%, a significant decrease from 70.2% in 1999.

Figure 9

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



(d) Canadian and U.S denominated borrowings

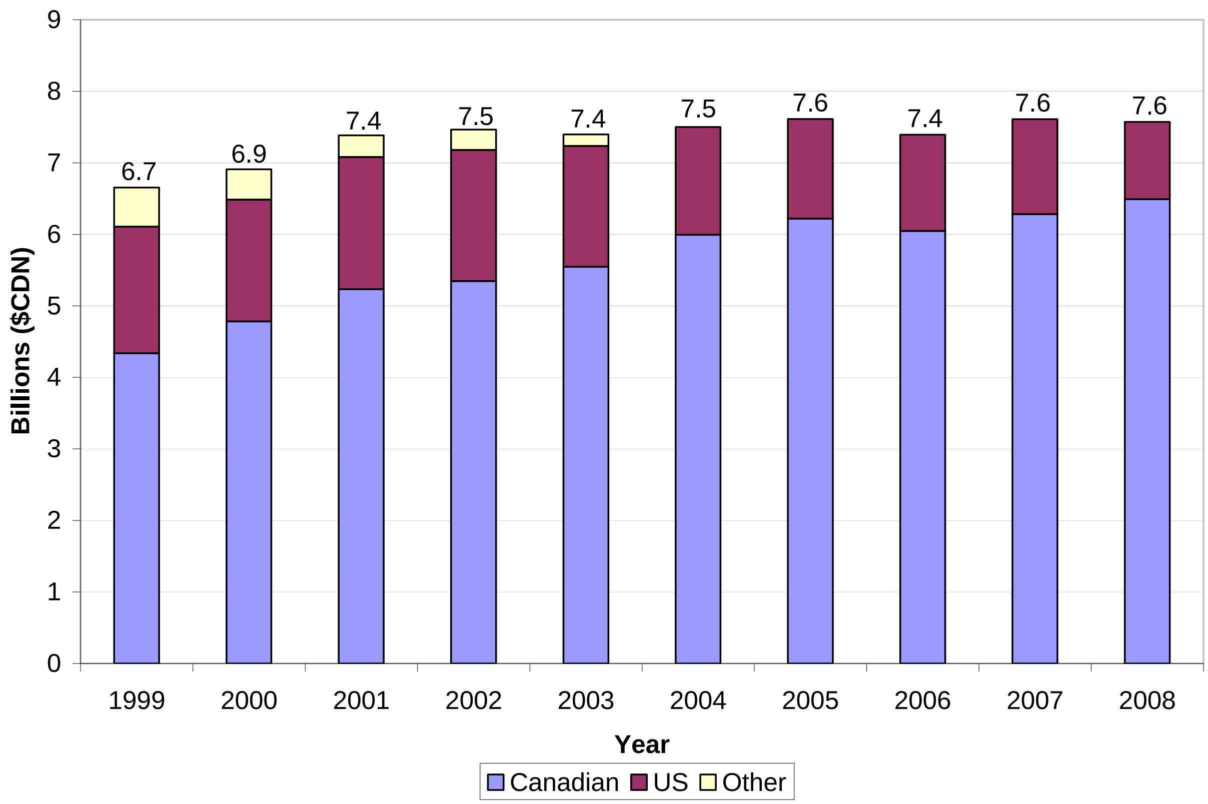
As at 31 March 2008, borrowings were reported in the Consolidated Statement of Financial Position at $6.8 billion, which represents total borrowings of $7.6 billion less sinking fund assets of $746 million. Total borrowings consist of general debentures in both Canadian and foreign currencies, amounts borrowed from the Government of Canada and its agencies, as well as other notes and loans payable by the Province. The $6.8 billion total borrowings of the Province, net of sinking fund assets for various debentures, is comprised of $6.254 billion in debt reflected in the Consolidated Revenue Fund, $186 million in health care organization debt, $184 million in Student Loan Corporation of Newfoundland and Labrador debt, $151 million in Newfoundland and Labrador Municipal Financing Corporation debt, $25 million in Newfoundland and Labrador Housing Corporation debt, and other miscellaneous debt of $25 million.

The net borrowings of $6.8 billion do not include the borrowings of Newfoundland and Labrador Hydro. This accounting policy is consistent with the recommendations of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants which require that the net equity position of a Government business enterprise such as Newfoundland and Labrador Hydro be recorded in the Consolidated Summary Financial Statements of the Province. In the audited financial statements of Newfoundland and Labrador Hydro for the year ended 31 December 2007, the Corporation reported debt of $1.4 billion (31 December 2006 - $1.5 billion).

Figure 10 shows the total borrowings as at 31 March for each year from 1999 to 2008 as disclosed in the Consolidated Statement of Financial Position. The Figure provides a breakdown of Canadian and foreign currency debt.

Figure 10

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



As Figure 10 shows, there were only Canadian and U.S. denominated borrowings as at 31 March 2008. The Canadian denominated borrowings totalled $6.5 billion and accounted for 86% of total borrowings.

(e) Borrowings and sinking funds

Many of the debentures held by the Province have sinking fund requirements. Sinking funds are a pool of cash and investments accumulated during the life of the debentures to repay the debt at maturity.

Figure 11 provides information on sinking funds as at 31 March 2008 along with the related debenture debt outstanding and the net amount left after reducing the debt by the amount of the sinking funds.

Figure 11

Consolidated Summary Financial Statements
Borrowings and Sinking Funds
As at 31 March 2008
($ Billions)

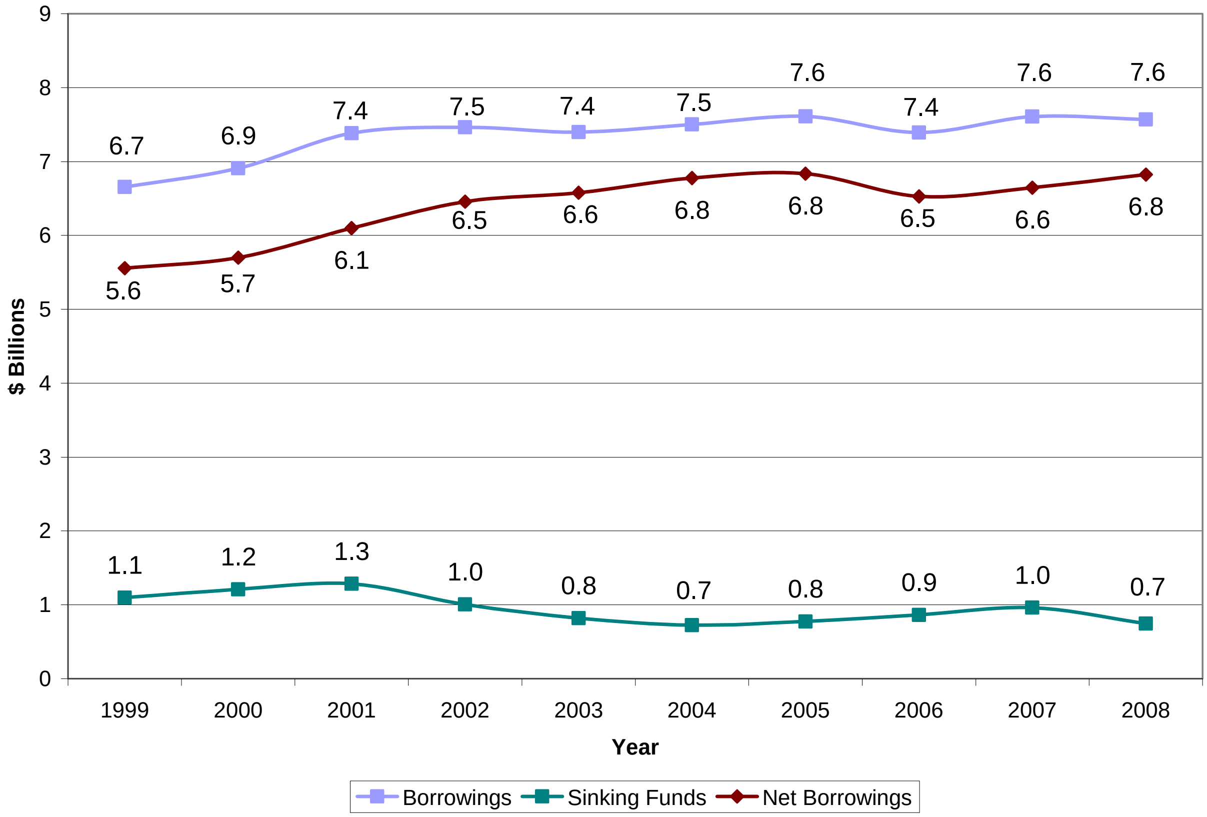
	Debt Outstanding	Sinking Fund Balance	Balance Net of Sinking Fund
Total Debt with Sinking Funds	4.182	0.746	3.436
Total Debt without Sinking Funds	3.389	-	3.389
Total	**7.571**	**0.746**	**6.825**

As Figure 11 shows, Government had approximately $746 million in sinking funds at 31 March 2008.

Figure 12 shows borrowings net of sinking funds for each of the past ten years.

Figure 12

Consolidated Summary Financial Statements
Borrowings and Sinking Funds
Years Ended 31 March
($ Billions)



As Figure 12 shows, there has been no significant change in these balances in recent years.

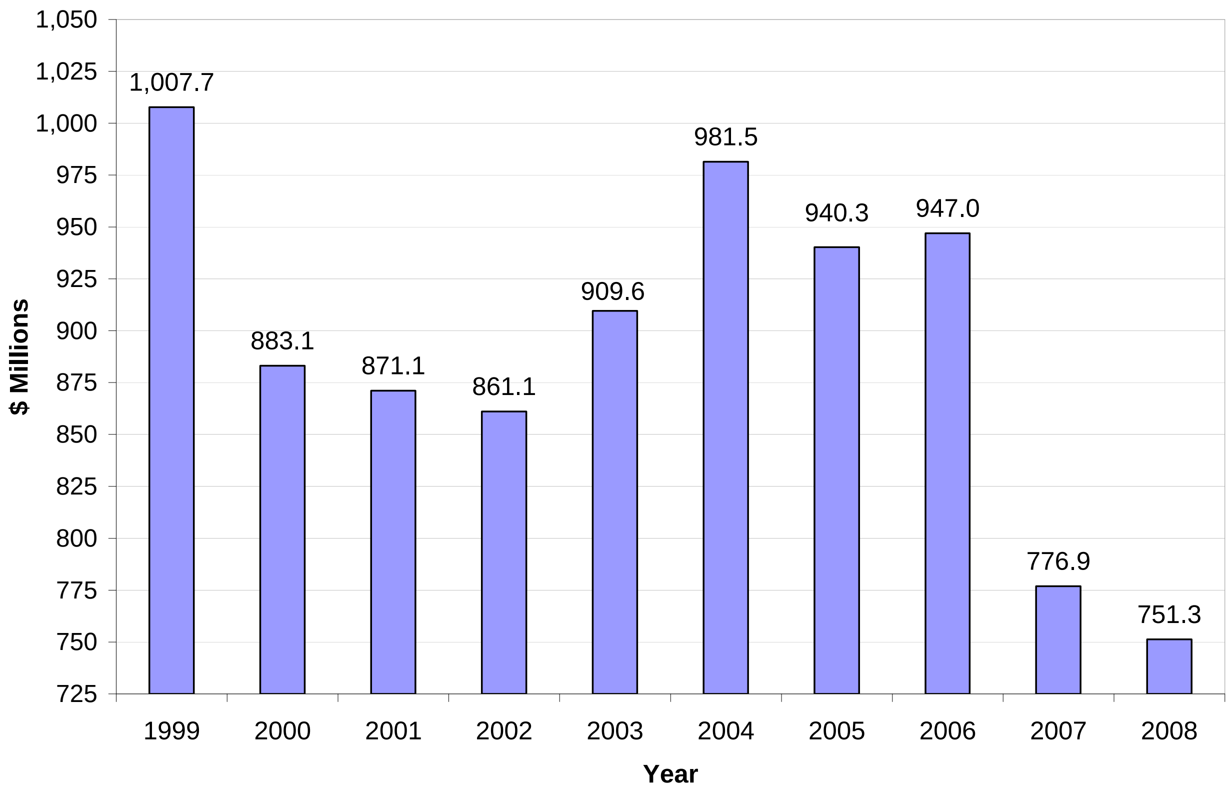
(f) Debt expenses

Debt expense (also known as the "interest bite") is the amount the Province has to pay to service its debt. The Province's debt expenses for 2008 as recorded in the Consolidated Summary Financial Statements totalled $751 million, which consists of $113.5 million for the unfunded pension liability, $76.8 million for the net liability for group health and life insurance retirement benefits, and $560.7 million for the Province's borrowings.

Total debt expenses for the Province for each year from 1999 to 2008 are outlined in Figure 13.

Figure 13

Consolidated Summary Financial Statements
Debt Expenses
Years Ended 31 March
($ Millions)



As Figure 13 shows, debt expenses have decreased significantly over the past 2 years primarily due to the impact of transferring approximately $2.0 billion of the proceeds from the Atlantic Accord (2005) agreement to reduce the unfunded liability of the Teachers' Pension Fund. Debt expenses as a percentage of total expenses has decreased from 24.6% in 1999 to 13.2% in 2008.

3.2.2 Flexibility

Flexibility is the degree to which a government can increase its financial resources to respond to rising commitments, by either expanding its revenues or increasing its debt. Flexibility indicators include:

- interest costs as a percentage of total revenue; and
- own source revenues to GDP.

Together with a government's net debt and a province's GDP, these indicators provide insight into a government's flexibility in responding to rising commitments. For example, when a government has a large net debt and high interest costs, it has fewer resources to allocate to programs and services.

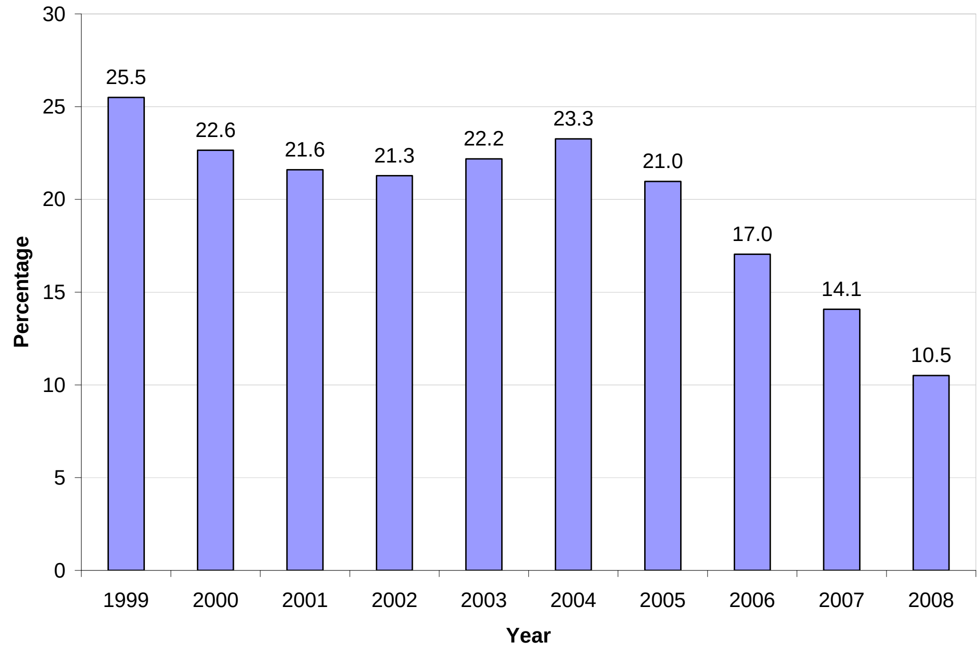
(a) Interest costs as a percentage of total revenue

Government incurs interest costs on its borrowings, as well as on its liabilities relating to retirement benefits. At 31 March 2008, Government's long-term borrowings net of sinking funds was $6.8 billion, its unfunded pension liability was $1.5 billion and its unfunded group health and life insurance retirement benefits liability was $1.5 billion. In 2008, Government's interest costs (debt expenses) totalled $751 million. The significance of debt expenses is that this money is not available to fund programs and services.

Interest costs as a percentage of total revenue, sometimes called the "interest bite", is an important indicator of the state of a government's finances. Figure 14 provides the total debt expenses as a percentage of total revenue for the years ended 31 March 1999 to 2008.

Figure 14

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



While Figure 14 indicates a significant decrease in debt expenses as a percentage of total revenue, these costs continue to be a substantial burden for Government. With 10.5 cents of every dollar in revenue going to debt expenses, Newfoundland and Labrador continues to have one of the highest debt expenses as a percentage of total revenue of any province in Canada.

Continued reductions in debt expenses would allow Government to use more of its revenues to pay for programs and services, and use less of its revenues to pay for debt expenses.

(b) Own source revenues to GDP

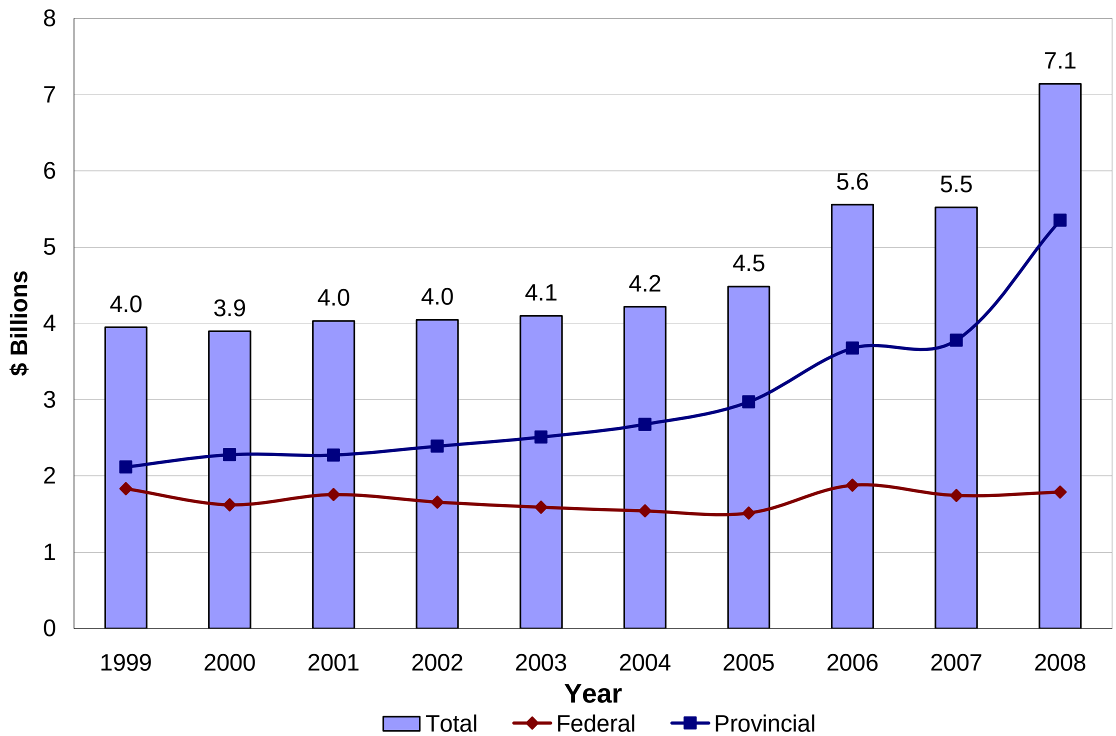
The Government of Newfoundland and Labrador receives revenue from two general sources. The first revenue source is from within the Province. This source is called "own source revenue". The second source of revenue is transfers from the Federal Government.

Government's own source revenue to GDP reflects how much revenue Government can raise from the Provincial economy e.g. through taxes and fees. It shows the extent to which Government obtains its revenues from the Provincial economy as opposed to transfers from the Federal Government, and the flexibility it has in increasing its financial resources through own source revenues if faced with decreases in Federal Government transfers.

Figure 15 provides information on own source and Federal revenues from 1999 to 2008.

Figure 15

Consolidated Summary Financial Statements
Revenue by Source
Years Ended 31 March
($ Billions)



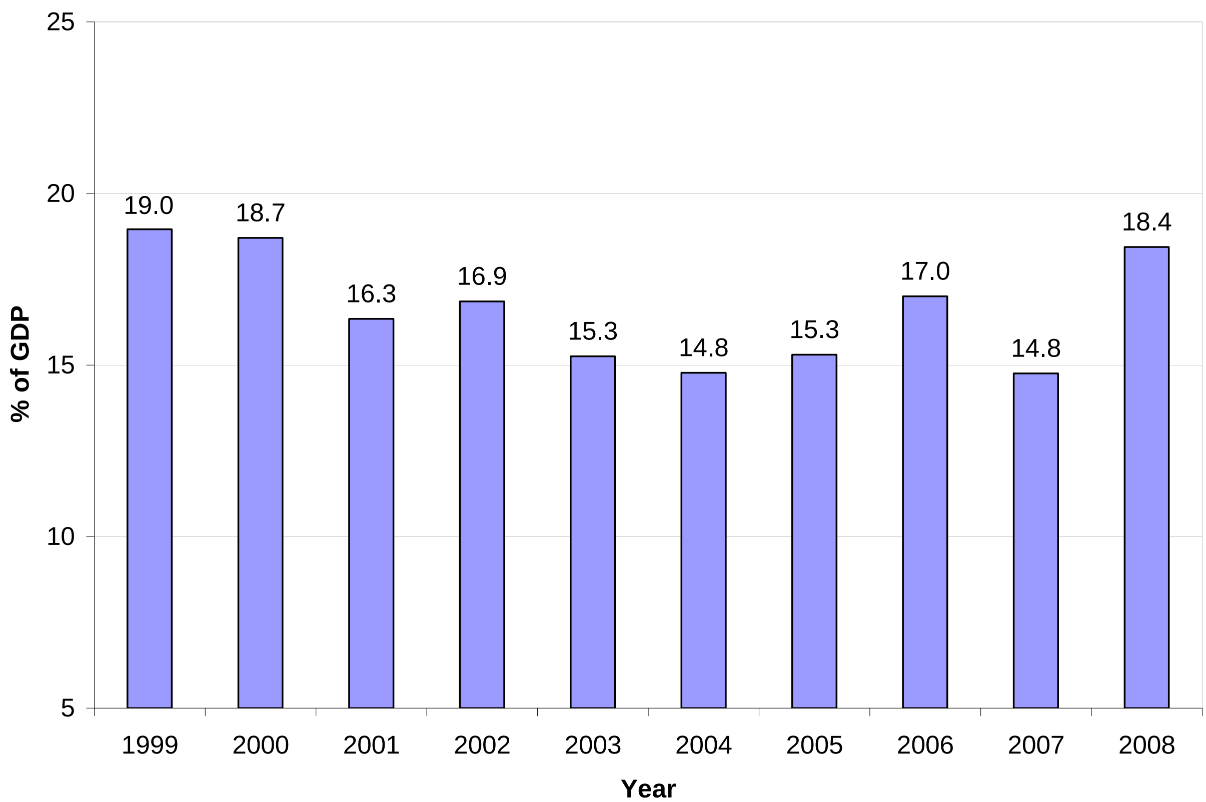
As Figure 15 shows, although a substantial portion of our total revenue continues to come from the Federal Government, there has been no significant change in this revenue source. At the same time, however, Provincial revenues have increased. As a result, Federal revenues as a percentage of total revenues have declined from 49.1% in 1999 to 25.0% in 2008.

Another important factor to consider is the comparison of the change in a government's own source revenue to the size of the economy as indicated by the GDP.

Figure 16 provides information on this indicator from 1999 to 2008.

Figure 16

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



As Figure 16 shows, revenue raised from sources within the Province, as a percentage of GDP, generally declined from 1999 to 2004. In 1999 the percentage was 19.0% while in 2008 it was 18.4%. This means that the Province is now taking about the same income out of the economy as it was in 1999.

3.2.3 Vulnerability

Vulnerability is the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence. This indicator measures the extent to which a government can manage its financial affairs without having to rely on others. Important vulnerability indicators include:

- Federal Government revenues compared to own source revenues;
- foreign currency debt to total government debt; and
- oil revenues as a percentage of own source revenues.

(a) Federal Government revenues compared to own source revenues

A comparison of Federal Government revenues to own source 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's revenue in this Province consists of transfers from the Federal Government such as equalization, Health and Social Transfers, and cost-shared programs.

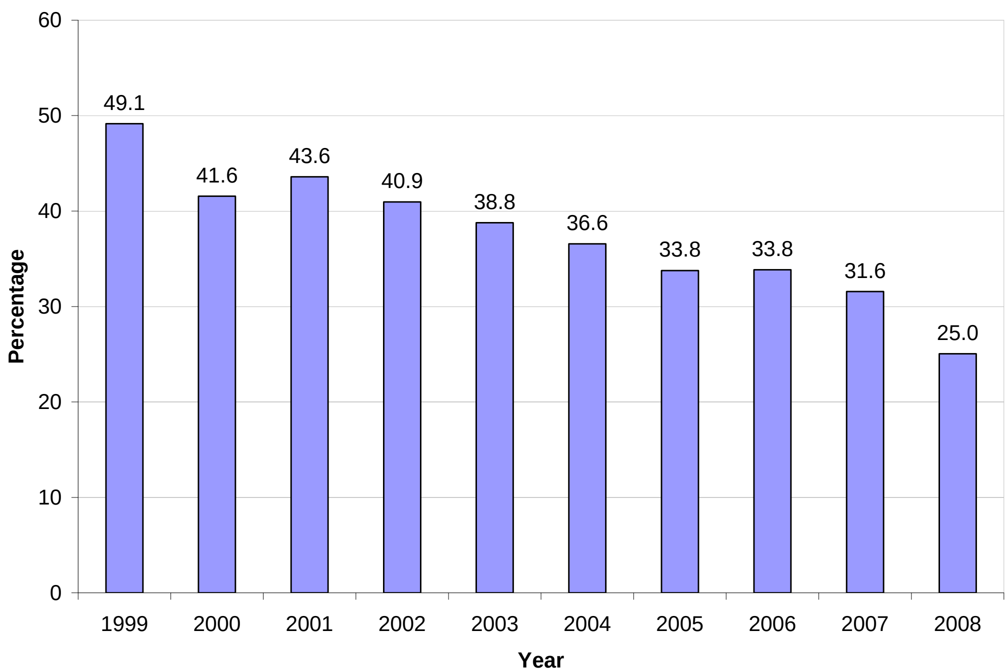
In the case of equalization, Government recently announced that for the first time in 60 years, Newfoundland and Labrador will not be receiving any equalization payments. The Province is now classified as a "Have Province", meaning that we are considered to be financially self-reliant. However, equalization transfers are affected by each province's performance in relation to the performance of other provincial economies, and therefore are subject to change.

Offshore oil royalties revenues have become the single largest own source revenue for Newfoundland and Labrador with the increase in this revenue being largely responsible for generating a surplus of $1.4 billion for 2008. The Province is especially vulnerable to changes in world oil prices and production levels. If resource revenues were to decline significantly it could result in the reversal of a "Have Province" to a Province that may possibly once more be a recipient of equalization payments from the Federal Government. To illustrate, the increased oil prices in the first eight months of the 2009 fiscal year will likely result in a higher than budgeted surplus for that year; however, Government announced in December 2008 that if oil prices continue at below US$60 per barrel, there could be deficits of several hundred million dollars in the 2010 fiscal year, as well as potential deficits in subsequent years.

Figure 17 provides information on the percentage of Federal revenues compared to the Province's total revenues from 1999 to 2008.

Figure 17

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



As Figure 17 shows, Federal revenue as a percentage of total revenue has generally declined since 1999. The significant decline in 2008 was primarily due to the substantial increase in own source revenues most notably from offshore oil royalties, in comparison to Federal revenues which remained relatively constant.

As indicated in Figure 17, over the past ten years, Federal revenue as a percentage of total revenue ranged from a high of 49.1% in 1999 to a low of 25.0% for 2008.

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.

(b) Foreign currency debt to total government debt

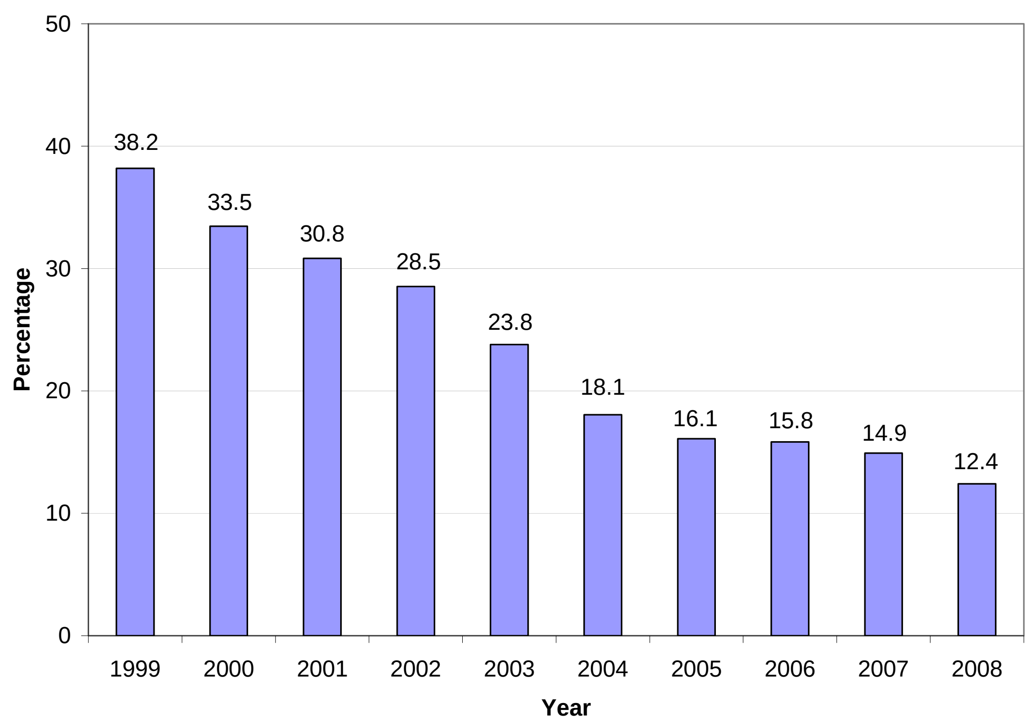
Of the $6.8 billion in total borrowings (net of sinking fund assets) as at 31 March 2008, $847 million was foreign (U.S.) debt.

A comparison of a government's foreign debt to its total debt reflects the degree to which it is vulnerable to currency swings.

Figure 18 provides information on the Province's foreign currency debt as a percentage of its total debt from 1999 to 2008.

Figure 18

Consolidated Summary Financial Statements
Foreign Currency Debt as a Percentage of
Total Debt (Net of Sinking Funds)
Years Ended 31 March



As Figure 18 indicates, over the last ten years, foreign currency debt as a percentage of total debt has been steadily decreasing from a high of 38.2 % in 1999 to a low of 12.4% in 2008.

Although foreign currency debt is decreasing, Government is still vulnerable to currency swings in relation to this debt. To illustrate, as indicated in the notes to the Public Accounts, subsequent to 31 March 2008 a significant unfavorable change in the US dollar exchange rate occurred. As of November 2008, the foreign exchange rate for one US dollar was $1.2247, a decrease of $0.1982 over the $1.0265 rate at year end. If, as at 31 March 2008, the foreign exchange rate had been $1.2247, there would have been an increase in foreign exchange losses of $163.6 million.

(c) Oil revenues as a percentage of own source revenues

There is a growing reliance by Government on oil revenue to fund its programs and services. This revenue source as a percentage of Provincial revenues has increased substantially in recent years. To illustrate, in 2004 oil revenue was $127 million (4.7% of own source revenue) while in 2008, oil revenue was $1.754 billion (32.8% of own source revenue).

However, world oil prices are highly volatile and production levels relating to such non-renewable resources can vary significantly. Therefore, changes in these factors can result in significant differences between budget forecasts and actual. As a result, Government's financial position can be significantly impacted by factors outside of its control.

Figure 19 shows budget and actual oil revenues from 2004 to 2008, along with budget and revised forecasts for 2009.

Figure 19

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

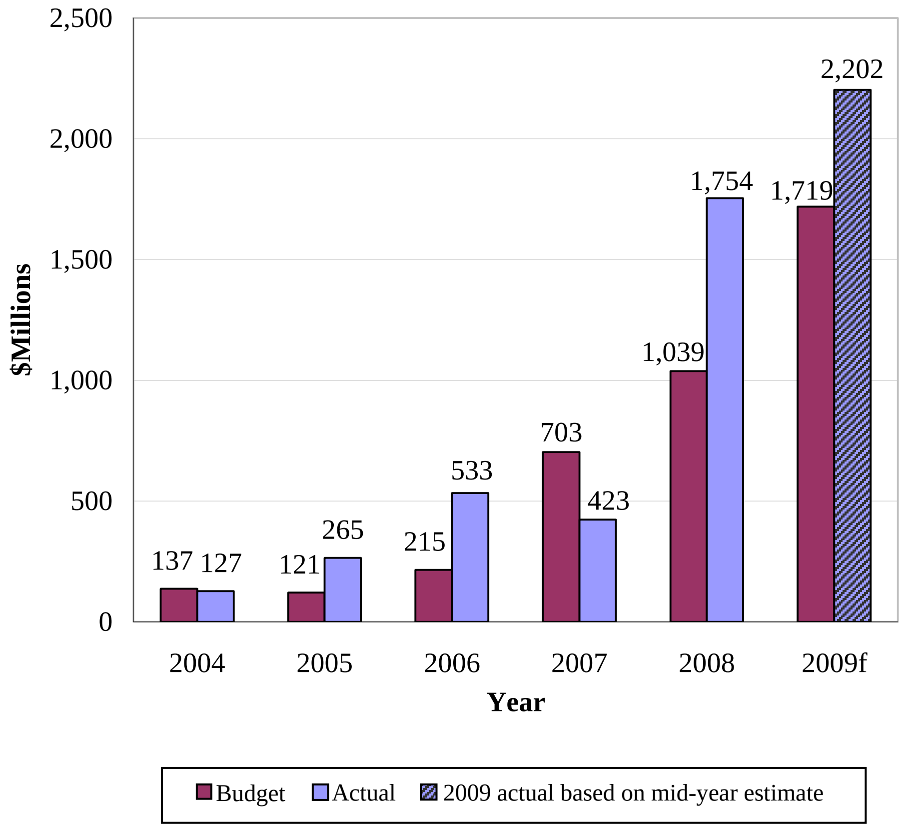
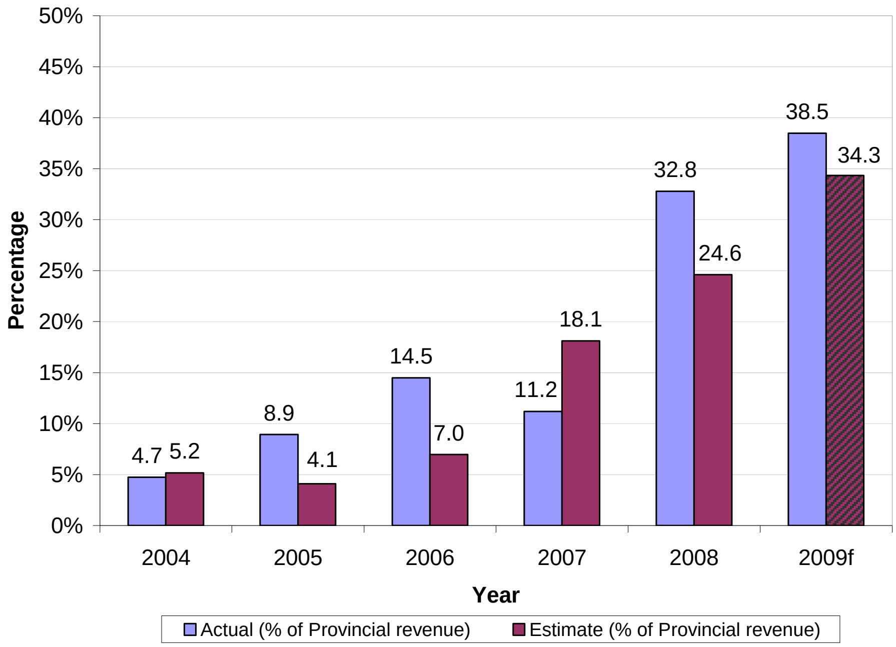


Figure 20 shows budget and actual oil revenues from 2004 to 2008 as a percentage of own source revenues, along with budget and revised forecasts for 2009.

Figure 20

Consolidated Summary Financial Statements
Oil Revenues: Percentage of Own Source Revenues
Years Ended 31 March



As Figures 19 and 20 show, oil revenues and the percentage of own source revenues they represent have increased significantly since 2004. The Figures also show that there have been significant differences between budget forecasts and actual oil revenues from 2004 to 2008 (and forecasted for 2009).

The significant increase in oil revenues, for the most part, is attributable to changes in oil prices and/or production levels. For example, in 2008, while oil revenues were budgeted at $1.039 billion, actual oil revenue was $1.754 billion, an increase of $715 million or 69%. This change could have been in either direction, and highlights the vulnerability associated with this revenue source. In fact, the opposite occurred in 2007 when oil revenue was budgeted at $703 million, with actual revenues of $423 million, representing a decrease of $280 million or 40%. The decrease was due to a longer than anticipated shutdown of the Terra Nova oil production facility. The difference between budget and actual demonstrates the volatility that exists in predicting oil revenues.

Furthermore, although oil revenue was budgeted for 2009 at $1.719 billion, in December 2008, Government announced an increase in its oil revenue estimates by $483 million to $2.202 billion in large part as a result of higher oil prices for a portion of that fiscal year. It was also announced that due to possible lower oil prices in the future, there could be deficits of several hundred million dollars in 2010, with potentially further deficits in subsequent years.

Given its lack of control over oil prices and production levels, and its increasing dependence 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.

3.3 Credit Rating

The Province's credit rating will affect the debt servicing costs over time because the interest that the Province will have to pay on its borrowing will decrease as the credit rating improves, and conversely, the interest costs will increase as the credit rating declines.

The Province's credit ratings as established by Dominion Bond Rating Services, Moody's Investors Services, and Standard and Poor's are outlined in Figures 21, 22 and 23 respectively.

Figure 21

**Province of Newfoundland and Labrador
Credit Ratings Established by
Dominion Bond Rating Service**

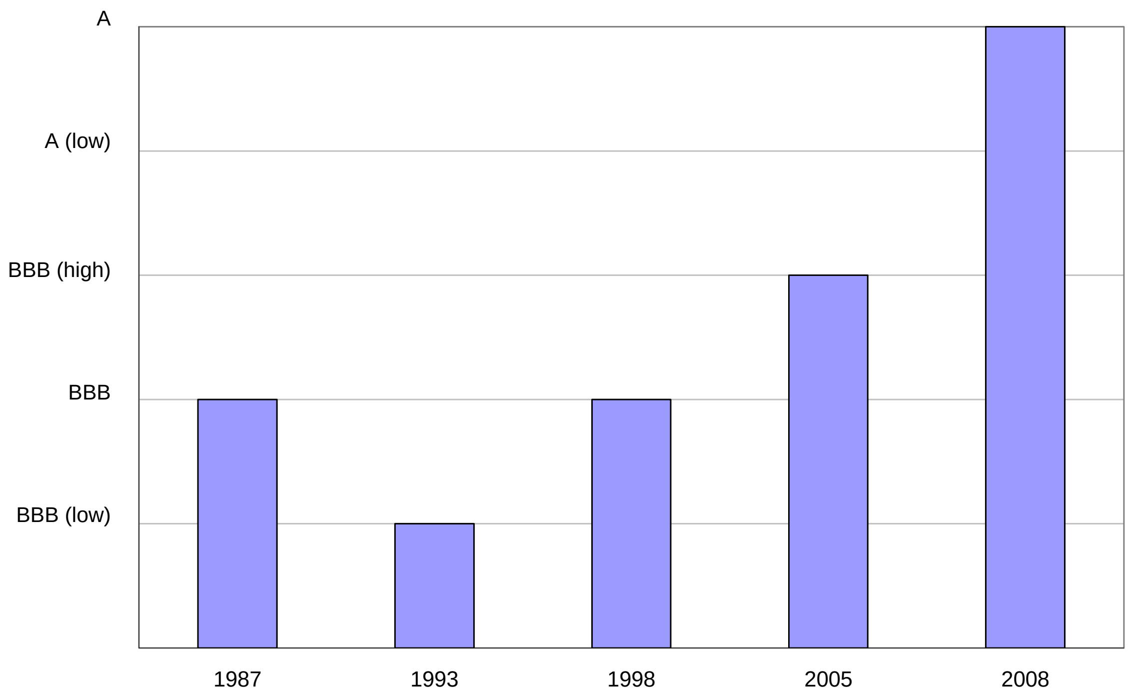


Figure 22

Province of Newfoundland and Labrador
Credit Ratings Established by
Moody's Investors Service

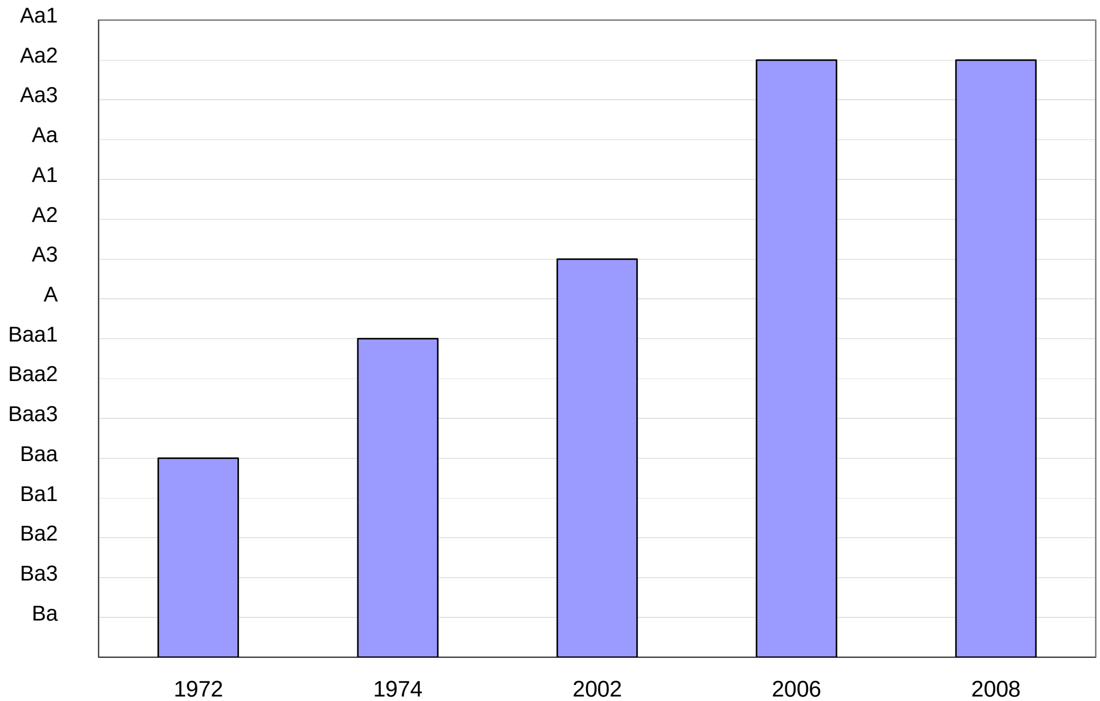


Figure 23

Province of Newfoundland and Labrador Credit Ratings Established by Standard & Poor's

Although these Figures show that the Province's credit rating has improved significantly, Figures 24, 25, and 26 which follow show that, while Newfoundland and Labrador is no longer the lowest rated Province in Canada, it is still rated among the lowest provinces.

Figure 24

Credit Ratings Established for Canada and the Provinces by Dominion Bond Rating Service

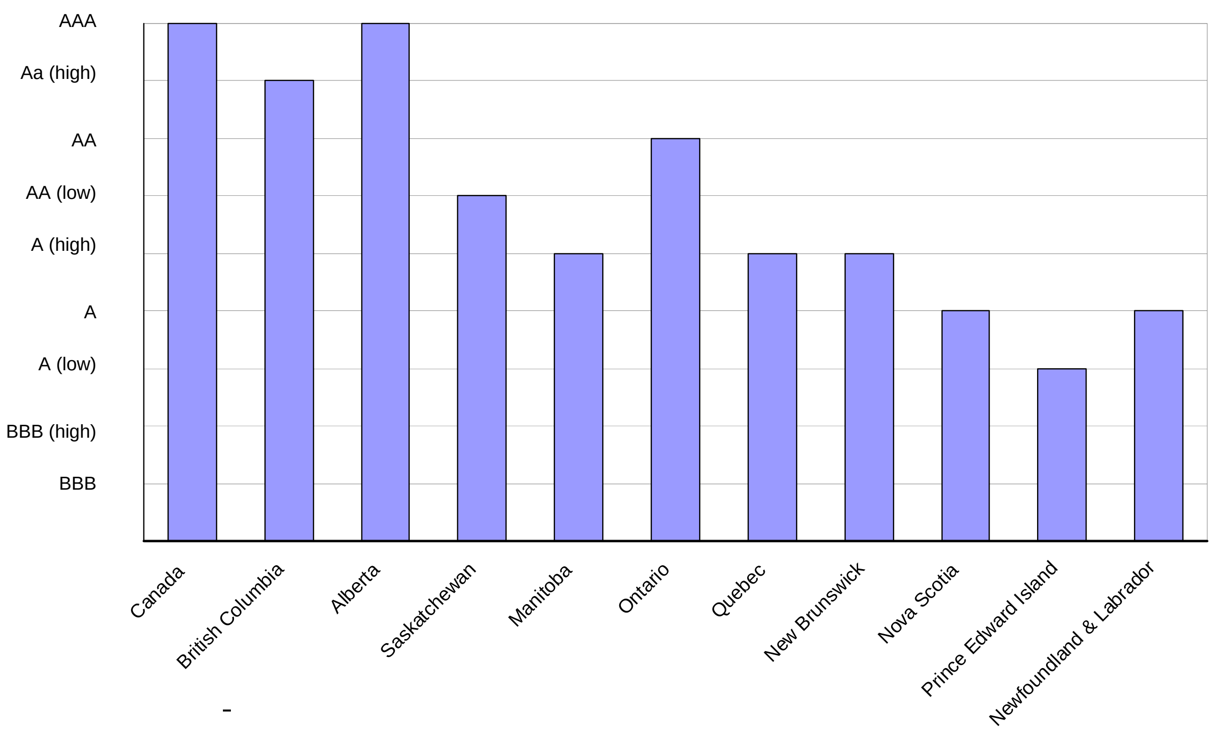


Figure 25

Credit Ratings Established for Canada and the Provinces by Moody's Investors Service

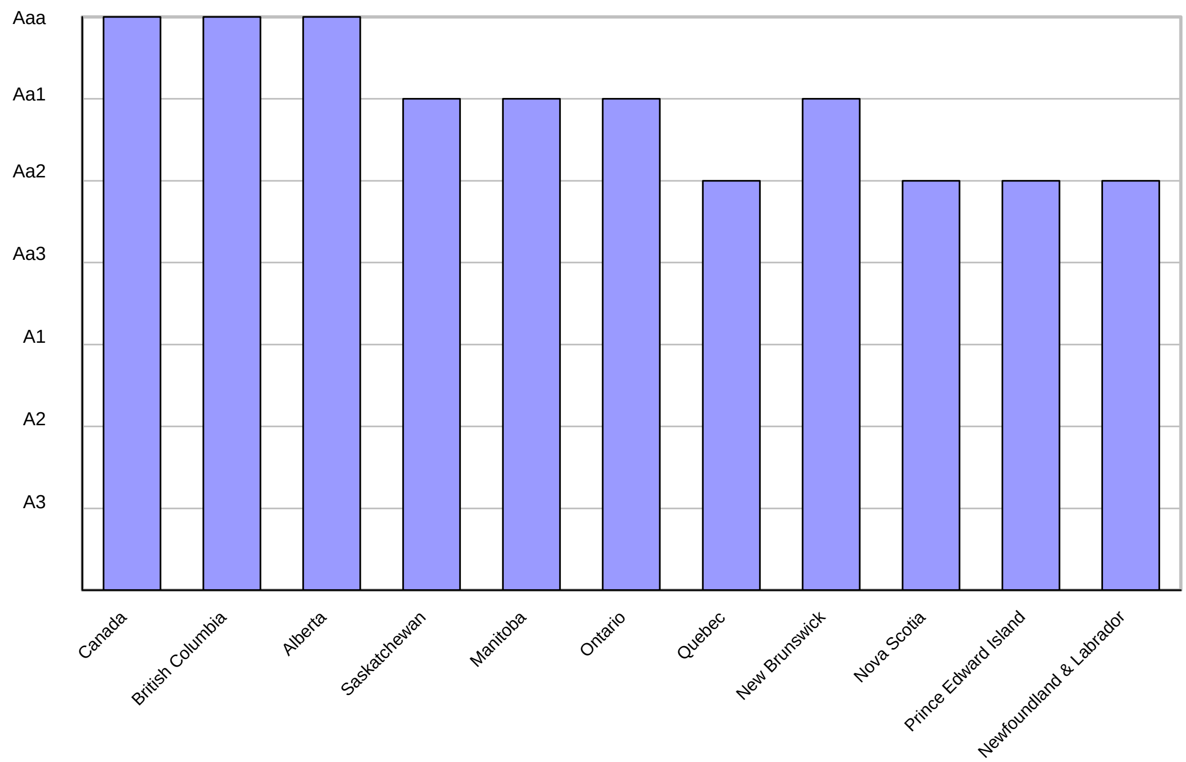
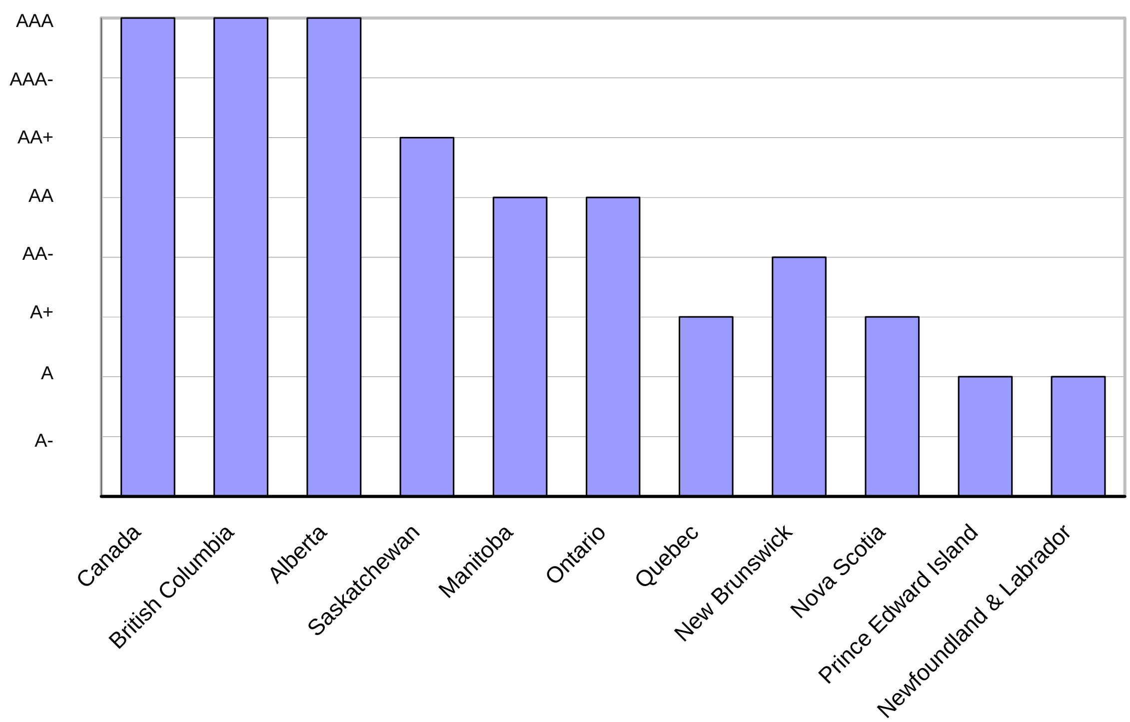


Figure 26

Credit Ratings Established for Canada and the Provinces by Standard & Poor's



CHAPTER
4
COMMENTS ON SELECTED FINANCIAL INFORMATION

4.1 Retirement Benefits - Pensions

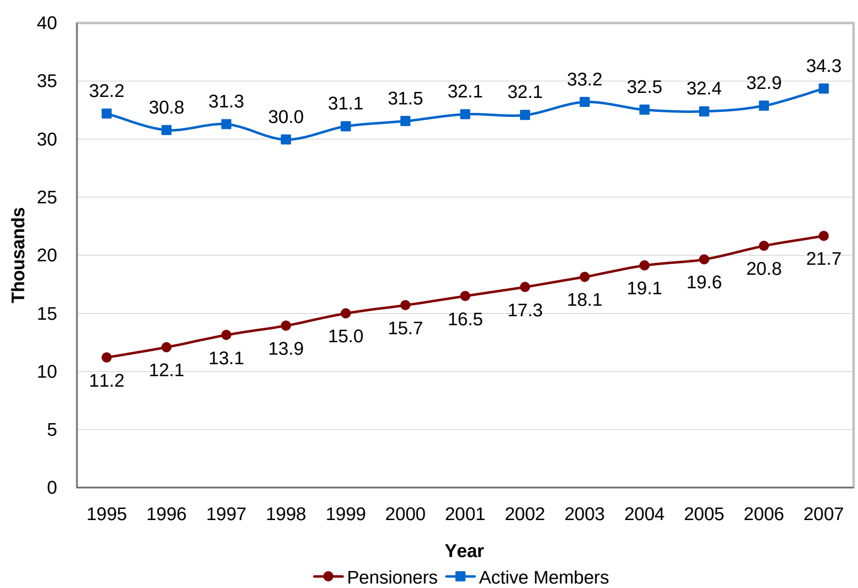
Pensions Administered under the Newfoundland and Labrador Pooled Pension Fund

Prior to 1967, public service salaries and pension benefits were paid under the authority of the *Civil Service Act.* Under that legislation there were no employee or employer contributions to a pension plan and pension benefits were paid out of the Consolidated Revenue Fund. In 1967, legislation was enacted which required that employees contribute to a pension plan. Employees' pension premiums were paid into the Consolidated Revenue Fund and pension benefits continued to be paid out of it.

In 1981, legislation was enacted which created the Province of Newfoundland and Labrador Pooled Pension Fund and required that employee and employer pension premium contributions be paid into the Fund. Subsequent to the establishment of the Fund, pension benefits were paid by the Fund irrespective of whether the employee had contributed pension premiums to it. Figure 1 provides historical data for the Fund relating to pensioners and active members for the past 13 years.

Figure 1

Province of Newfoundland and Labrador Pooled Pension Fund
Population History: Pensioners and Active Members
Years Ended 31 December
(000's)



As at 31 December 2007, the Province of Newfoundland and Labrador Pooled Pension Fund was comprised of the following five pension plans:

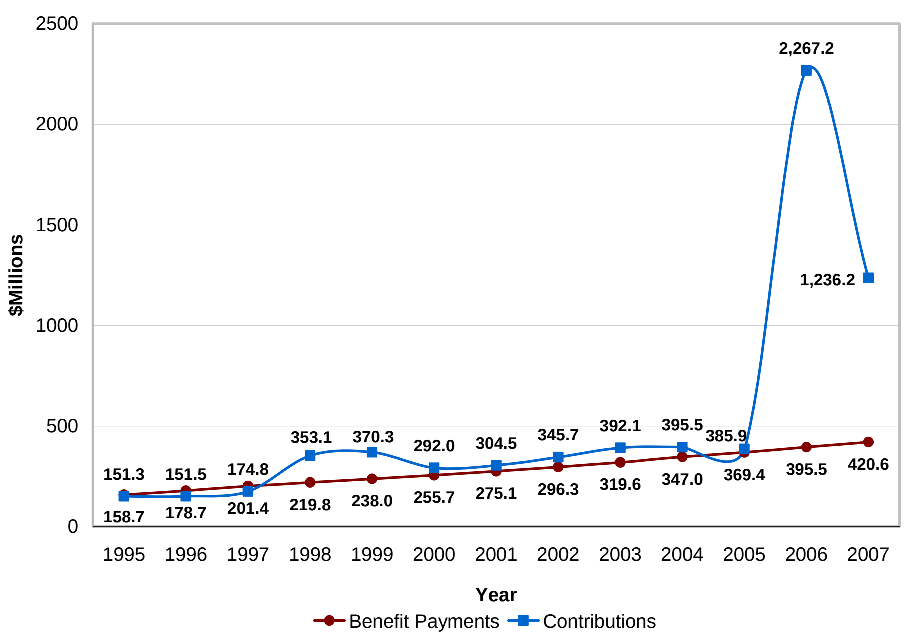
- Public Service Pension Plan;
- Teachers' Pension Plan;
- Uniformed Services Pension Plan;
- Members of the House of Assembly Pension Plan; and
- Provincial Court Judges' Pension Plan.

All employee and employer contributions are deposited into the Fund and pension benefits to plan members and other pension payments are made from it.

For the year ended 31 December 2007, approximately 34,300 employees, Members of the House of Assembly, and the employer paid pension contributions totalling $1.236 billion into the Pension Fund under the five pension plans. During the same period, the Fund provided benefits totalling $420.6 million to approximately 21,700 retirees. Figure 2 provides historical data for the Fund relating to pension benefits paid and pension contributions received for the past 13 years.

Figure 2

Province of Newfoundland and Labrador Pooled Pension Fund
Pension Benefit Payments and Contributions
Years Ended 31 December
($ Millions)



Memorial University of Newfoundland Pension Plan

Commencing with the year ended 31 March 2006, the Province included Memorial University of Newfoundland (MUN) in its reporting entity.

MUN's plan is a defined benefit pension plan for its full-time employees and is administered separately from the plans administered under the Province of Newfoundland and Labrador Pooled Pension Fund.

As at 31 March 2008, the MUN plan had 3,368 active participants and 1,092 pensioners. For the year ended 31 March 2008, the employer and employees paid pension premiums totalling approximately $38 million, and provided benefits to pensioners of approximately $33 million.

Unfunded Pension Liability

The unfunded pension liability as at 31 March 2008, including the unfunded liability of the MUN plan of $10.9 million, totalled $1.459 billion. This is a decrease of $466 million from the balance of $1.925 billion as at 31 March 2007. The main reason for the decrease in the unfunded pension liability was the payment of $582 million by the Province during 2007-08 to help reduce the Public Service Plan's unfunded liability.

The $1.459 billion unfunded pension liability continues to represent a significant debt for Government. Information on the overall unfunded pension liability from 1999 to 2008 is outlined in Figure 3.

Figure 3

Consolidated Summary Financial Statements
Unfunded Pension Liability
As at 31 March
($ Billions)

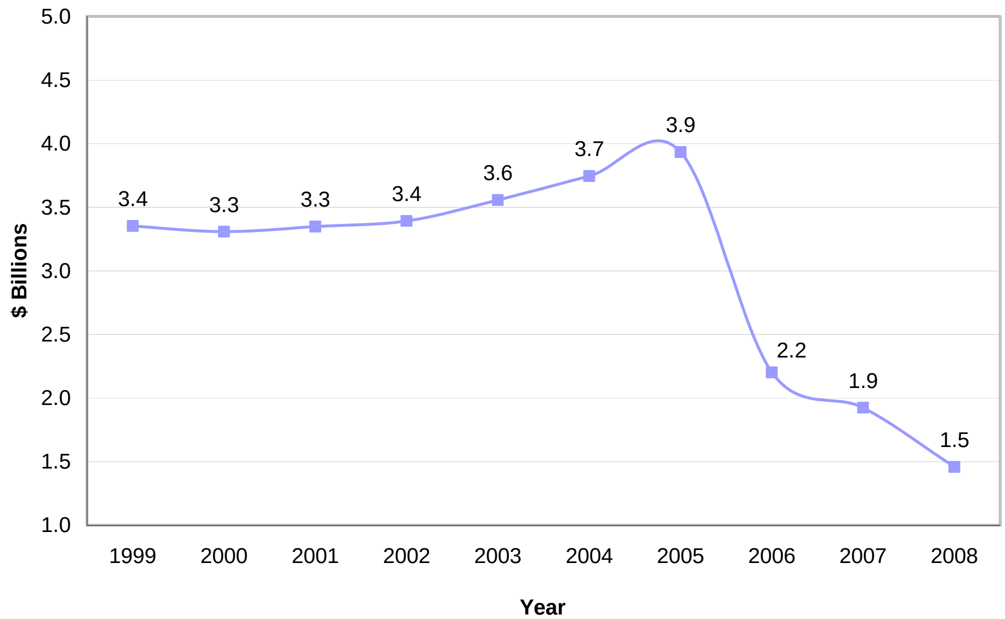
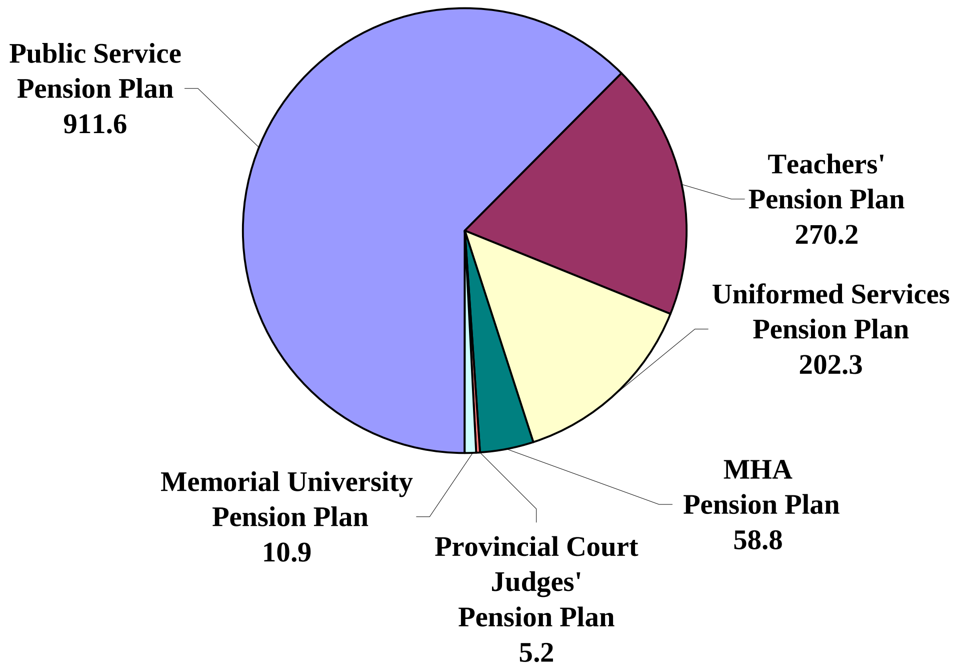


Figure 4 shows the unfunded pension liability by plan as at 31 March 2008.

Figure 4

Consolidated Summary Financial Statements
Unfunded Pension Liability by Plan
As at 31 March 2008
($ Millions)



Although the total unfunded pension liability decreased from 2007, the liability increased by a total of $55.2 million in four of the pension plans included in Figure 4 - the Teachers' Pension Plan ($32.8 million), the Uniformed Services Pension Plan ($17.8 million), the Members of the House of Assembly Pension Plan ($4.0 million) and the Provincial Court Judges' Pension Plan ($0.6 million).

Pension Fund Assets

As indicated in the Consolidated Summary Financial Statements, subsequent to 31 March 2008, there was a significant decline in the market value of the Province's pension fund assets. The market value decreased from approximately $7.2 billion as at 31 March 2008 to $5.6 billion in November 2008, a decrease of $1.6 billion or 22%. It was disclosed in the statements that the reason for this significant decline was the effect that the global economic uncertainty has had on the financial markets. This decline in asset value means that the Province's unfunded liability has increased.

Special Payments

(a) Public Service Pension Plan

During 2007-08, the Province paid $582 million into the Fund to help reduce the unfunded liabilities of the Public Service Pension Plan. As at 31 March 2008, the net unfunded liability for the Plan was $912 million, a decrease of $514 million from the 2007 unfunded liability of $1.426 billion.

(b) MUN Pension Plan

During 2007-08, MUN made a special payment of $6.7 million to help reduce the balance of its unfunded liability. As at 31 March 2008, the net unfunded liability for the MUN Pension Plan was $10.9 million, a decrease of $6.5 million from the 2007 unfunded liability of $17.4 million. (MUN was included in the Consolidated Summary Financial Statements for the first time in 2006).

Interest Costs

The interest costs relating to the pension plans each year from 1999 to 2008 are outlined in Figure 5.

Figure 5

**Consolidated Summary Financial Statements
Interest Costs on the Unfunded Pension Liability
Years Ended 31 March
($ Millions)**

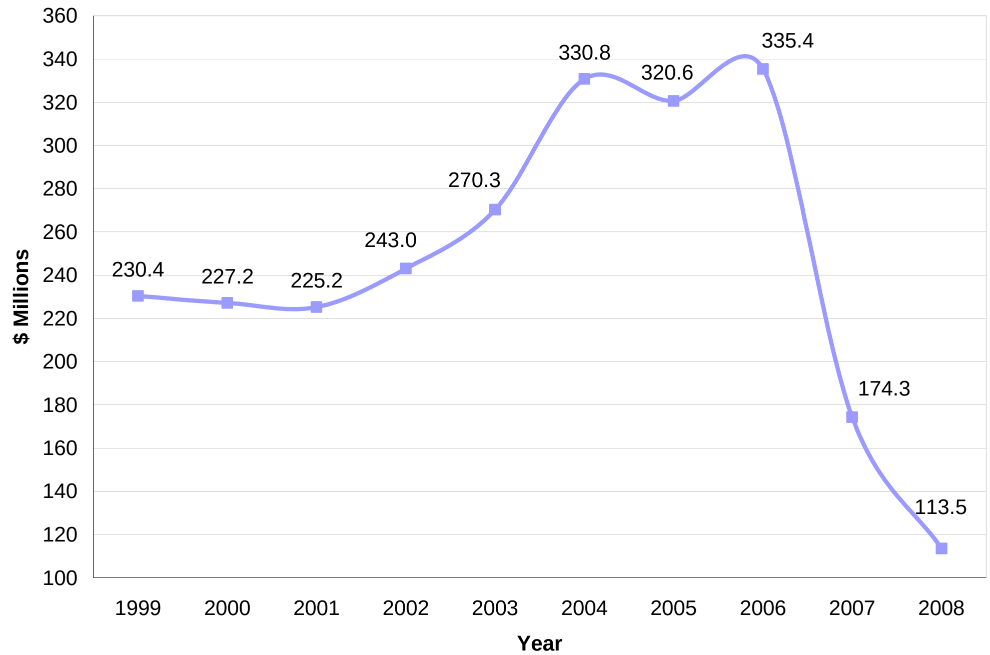


Figure 5 indicates that from 2001 to 2006 there was a significant increase in interest costs associated with the Province's unfunded pension liability. In 2001, interest costs amounted to $225.2 million while in 2006 interest costs were $335.4 million, an increase of $110.2 million or 49%. In 2007 and 2008, there were large decreases in interest costs. Although impacted by declining interest rates, the decreases were primarily due to the impact of the additional special payment of $1.953 billion to the Teachers' Pension Plan in March 2006.

Recommendation

Government should continue to closely manage the Province's unfunded pension liability.

4.2 Retirement Benefits - Group Health and Life Insurance

Active and retired public sector employees are eligible to participate in group health and group life insurance plans. Plans for active and retired Government employees, Members of the House of Assembly and Provincial Court Judges are managed by Government. Plans for teachers are managed by the Newfoundland and Labrador Teachers' Association and plans for employees of Memorial University of Newfoundland are managed by the University.

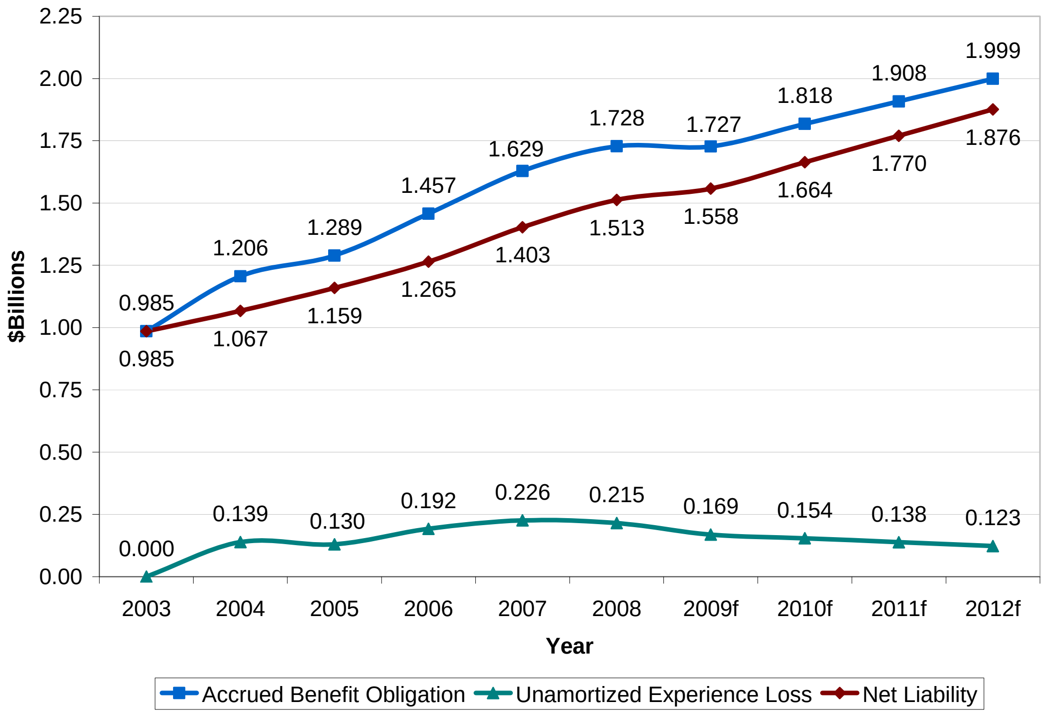
As at 31 March 2008, the plans provided benefits to a total of 19,148 retirees. Obligations for retirement benefits result from a commitment by Government to provide benefits to employees on retirement in return for their current services. Extended health care and life insurance benefits are a form of compensation offered for current services rendered by employees and accrue over the years employees work. The fundamental accounting task is to determine the amount of the total obligation for future retirement benefits and to determine the cost of future benefits for each year of employee service (current service cost).

The net liability relating to group health and group life insurance retirement benefits recognized in the Province's Consolidated Summary Financial Statements as at 31 March 2008 was $1.513 billion (2007 - $1.403 billion).

Figure 6 provides information regarding the projected net liability as extrapolated to 31 March 2012.

Figure 6

Province of Newfoundland and Labrador
Group Health and Group Life Insurance
Net Liability
As at 31 March
($ Billions)



f – The forecasted amounts relate to CRF only.
Source: Public Accounts and Actuarial Valuation

The liability for retirement benefits other than pensions has added to the already considerable debt load of the Province and, as Figure 6 shows, is expected to increase in each of the next four years. By 2012 the net liability is expected to total $1.876 billion, an increase of $891 million or 90% over 2003, if action is not taken to address it.

Recommendation

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

CHAPTER

5

COMMENTS ON GOVERNMENT'S FINANCIAL REPORTING

5.1 Generally Accepted Accounting Principles

The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants prescribes generally accepted accounting principles (GAAP) for the public sector in Canada. PSAB pronouncements represent the consensus of senior government officials, legislative auditors and other experts in public sector accounting across Canada. They represent minimum standards for governments and are the benchmark for acceptable financial reporting.

Government in this Province has made significant progress by preparing financial statements that provide information about the operating results and financial position of the Province in accordance with GAAP. However, there are still issues that should be addressed which would improve its overall financial reporting.

5.2 Government Reporting Entity

Under the standards established for governments by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants, the Province's Consolidated Summary Financial Statements are required to include all organizations that are controlled by Government. A detailed listing of organizations and enterprises included as part of the Government reporting entity is presented in a schedule to the statements.

Government considers the Workplace Health, Safety and Compensation Commission to be a form of trust and has disclosed information on the Commission's net fund deficiency ($29.4 million) and accumulated operating deficit ($84.5 million) as at 31 December 2007 in a note to the Schedule of Trust Accounts in the Consolidated Summary Financial Statements. Accounting for entities similar to the Workplace Health, Safety and Compensation Commission continues to evolve, with variations among jurisdictions in Canada.

Recommendation

Government should continue to monitor how other jurisdictions in Canada account for entities similar to the Workplace Health, Safety and Compensation Commission.

5.3 Environmental Liabilities

There are many sites in the Province which have environmental contamination resulting from such things as PCBs, old fuel storage tanks and solid waste landfills. These sites include, for example, the old Harmon air force base, Octagon Pond, Buckmaster's Circle, Marystown Shipyard and abandoned mining properties.

In my 2002 Annual Report to the House of Assembly, I concluded that:

"There is no central inventory of contaminated sites ... The lack of a central inventory makes it more difficult for Government to determine the nature and extent of contaminated sites in the Province, the extent of progress of remediation efforts, and estimated future remediation costs to be incurred by Government."

Although Government has started to capture information on contaminated sites, there is still no complete central inventory of such sites.

Government will ultimately have involvement with all contaminated sites in the Province; however, the extent of the involvement and resulting financial costs may vary. Costs associated with remediation are usually significant - for example Government spent approximately $18.9 million to complete remediation at the former Hope Brook Gold Mine property. While it is possible that the Province may be able to recover some of the remediation costs from other parties, the remaining remediation costs associated with contaminated sites would likely be significant.

Generally accepted accounting principles require that, if a reasonable estimate of the costs of the environmental remediation of Government-owned sites can be determined and it is likely that the Province will be liable for these costs, this amount should be recorded in Government's financial statements. Note 8.(c)(vi) to the statements indicates that "... *while the Province is aware of a number of contaminated sites, the full extent of the remediation costs for these known sites is not readily determinable".*

Although the Province's environmental liability relating to remediation costs for contaminated sites may be a significant amount, only $8.3 million (2007 - $7.3 million) has been recorded as a liability in the Province's financial statements. A financial report made public by Government in January 2004 indicated that *"The Province is facing environmental issues requiring more than $237 million for compliance with legislation and for* *remediation...."* The report indicated that the issues were spread across several departments and agencies, each of which had indicated an inability to handle remediation costs within the current expenditure levels. The most significant environmental issue reflected in the report related to regional waste sites.

Government has made little progress in this area since I first reported my concerns in 2002.

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

Recommendation

Government should continue with its efforts to identify all contaminated sites in the Province for which it is potentially liable, determine the estimated liability associated with remediation cost, and comply with generally accepted accounting principles by recording any resulting liability in the Province's financial statements.

5.4 Periodic Financial Statements

Periodic financial statements, while not specifically required by generally accepted accounting principles, are considered to be an important component of any financial accountability framework. These statements are important to effectively monitor and control Government's financial operations.

Since September 2002, Government has been preparing periodic financial statements to show the Province's results of operations and financial position. However, officials of the Department of Finance indicated that these financial statements are only distributed to the Minister of Finance/President of Treasury Board, other Treasury Board Ministers, the Deputy Minister of Finance, the Comptroller General, various officials of the Department of Finance, and the Auditor General.

While I have commended the Office of the Comptroller General in the past for preparing such financial statements; in my opinion, these financial statements should be more widely distributed. Ideally, these financial statements should be part of accountability information provided on an on-going basis to all Members of the House of Assembly and senior Government officials.

Recommendation

Periodic financial statements should be provided to Members of the House of Assembly and senior Government officials as part of Government's accountability framework.

5.5 Accounting for Federal Revenues

Government currently records Federal revenues based on regular entitlements received for the current year, with adjustments made against future years' revenues when known. These revenues include equalization transfers, health and social transfers, personal income taxes, corporate income taxes, and Harmonized Sales Taxes (HST). As I noted in past Reports, financial reporting would be improved if Government provided a reasonable estimate of future revisions, rather than wait until actual adjustments become known.

Recommendation

Government should develop a reasonable basis for estimating future revisions to entitlements, which could be used as a basis for recording Federal Government revenues.

APPENDICES

APPENDIX
I

ANSWERS TO FREQUENTLY ASKED QUESTIONS

ABOUT THE PUBLIC ACCOUNTS

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 that year.

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 31 March 2008 were published in two volumes:

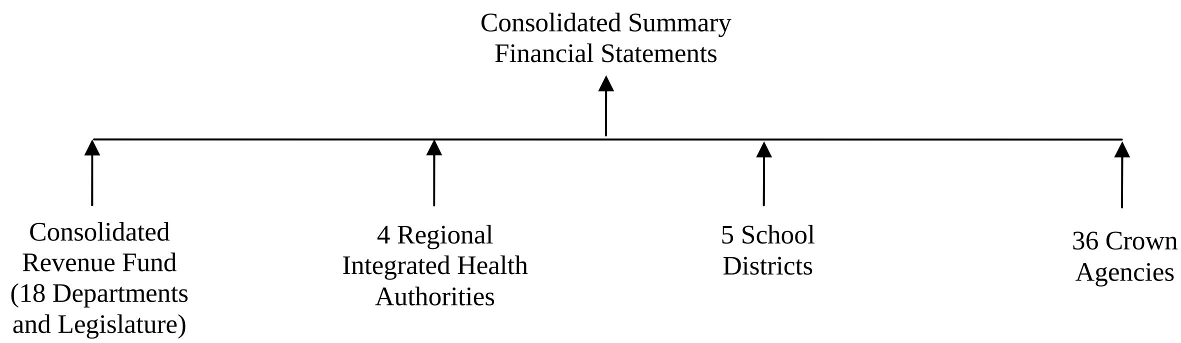
Volume I - Consolidated Summary Financial Statements

This Volume presents the Consolidated Summary Financial Statements of the Province of Newfoundland and Labrador on an accrual basis of accounting. 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 18 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:

Figure 1

Entities included in the Consolidated Summary Financial Statements
31 March 2008



As Figure 1 shows, the Consolidated Summary Financial Statements include the financial activities of the Consolidated Revenue Fund as well as 45 other entities (4 regional integrated health authorities, 5 school districts and 36 Crown agencies). There are 18 other entities which are not included in the Consolidated Summary Financial Statements as their financial activities are included with either the Consolidated Revenue Fund or with parent entities already included in the 45 entities, or are not considered to be controlled by Government.

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 18 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:

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 reduce liabilities. Liabilities include borrowings as well as liabilities relating to retirement 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.

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.

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.

Statement of Change in Accumulated Deficit

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

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 the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA), 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's recommendations relating to financial reporting by governments are generally accepted within Canada, section 59 of the *Financial Administration Act* 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 accrual of retirement benefits, the amortization of foreign exchange gains or losses, and the allowance for guaranteed debt. 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 Public Accounts. Section 11 of the *Auditor General Act* requires that the Auditor General express an opinion as to whether the financial statements 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 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.

What assurance do Members of the House of Assembly have that the information provided in the Public Accounts is appropriate, credible and complete? How can Members know that the information they receive accurately reflects the results of the activities of Government?

The answer is that the House of Assembly uses the services of the Auditor General to assist it in carrying out its oversight responsibilities.

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. Material misstatement refers to an item or group of items that if omitted or misstated, would alter the decisions of reasonably knowledgeable financial statement users. The tolerable level of error or misstatement is a matter of judgment.

We obtain reasonable assurance on the financial statement figures because it would not be cost effective to obtain absolute assurance - we cannot audit every transaction. 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 on the financial information of Crown agencies which are consolidated in the Province's financial statements, by reviewing the agencies' audited financial statements and, in the case of agencies which are not audited by the Auditor General, by obtaining and reviewing information from the auditors of the agencies.

APPENDIX
II
GLOSSARY

Glossary

Accrual basis	A method of accounting whereby revenues are recorded when earned and expenses are recorded when incurred.
Accumulated surplus/deficit	This equals the net accumulation of all annual surpluses and deficits experienced by the Province.
Annual surplus/deficit	The difference between a government's annual revenues and expenses.
Atlantic Accord Agreement	During 2005-06, enabling legislation was passed by the Federal Government for the Agreement which provides 100% claw back protection for offshore revenues for the eight year period from 2004-05 to 2011-12. Following the passing of the Agreement, the Province received a $2.0 billion advance payment in July 2005.
CICA	The Canadian Institute of Chartered Accountants.
Consolidated Revenue Fund	All revenues over which the Legislature has power of appropriation form one Consolidated Revenue Fund. This currently includes the financial operations of the 18 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 (CHST) and Equalization payments.
Financial assets	Assets of a government (such as cash, investments, loans and accounts receivable) that can be converted to cash in order to pay government's liabilities or finance its future operations.

Glossary

Generally accepted auditing standards (GAAS)	This refers to the auditing standards that the Office of the Auditor General follows in order to be consistent in its auditing practices with similar organizations and to comply with the standards as proclaimed by the CICA. The authority for GAAS is the CICA.
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.*
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 a 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 CICA. 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.